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In The

Supreme Court of the United States

CHASE MANHATTAN BANK, USA, N.A.,

Petitioner,

vs.

HAROLD S. TAXEL, Chapter 7 Trustee,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

JAMES C. MITCHELL*
MITCHELL | GILLEON LAW FIRM
1320 Columbia Street, Suite 200
San Diego, CA 92101
Tel: 619.702.8623
Fax: 619.702.6337
Email: jcm@mglawyers.com

Attorneys for Petitioner
Chase Manhattan Bank, USA, N.A.
**Counsel of Record*

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

ISSUES PRESENTED

1. Should a bankruptcy trustee's hypothetical bona fide purchaser status, that defines the trustee's power to avoid transfers of a debtor's real property under 11 U.S.C. § 544(a)(3), be measured or limited by information about the real property contained in a bankruptcy petition and/or a debtor's required schedules that are electronically filed at the same instant as the petition?

2. Has the United States Court of Appeals for the Ninth Circuit interpreted the scope and meaning of 11 U.S.C. § 544(a)(3), and a bankruptcy trustee's avoiding powers under this statute, in a way that abrogates or conflicts with California Supreme Court decisions on the issue of when a prospective purchaser of real property in California is put on inquiry or constructive notice of facts affecting title to real property?

PARTIES

Petitioner Chase Manhattan Bank, USA, N.A. is a nationally chartered bank under the laws of the United States of America. Per Supreme Court Rule 29.6, Chase's Corporate Disclosure Statement, filed February 5, 2008, in the Court of Appeals for the Ninth Circuit, "that no parent corporation or publicly held corporation owns 10% or more of the stock of appellant [Chase]" is still correct and valid.

Respondent Harold S. Taxel is the duly appointed chapter 7 bankruptcy trustee in *In re Jill C. Deuel*, United States Bankruptcy Court, Southern District of California, Case No. 04-02787-JH7.

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The published opinion of the United States Court of Appeals for the Ninth Circuit, filed January 28, 2010 and reported at 594 F.3d 1073 (9th Cir. 2010). (App. 1-16.)

The published opinion of the United States Bankruptcy Appellate Panel of the Ninth Circuit ("BAP"), filed December 28, 2006 and reported at 301 B.R. 509 (BAP 9th Cir. 2006). (App. 17-37.)

JURISDICTION

This case is an adversary/core proceeding by petitioner Chase Manhattan Bank, USA, N.A. ("Chase") against respondent Harold S. Taxel, the bankruptcy trustee ("Taxel"), in a chapter 7 bankruptcy filed in the United States Bankruptcy Court, Southern District of California, by debtor Jill C. Deuel ("Deuel") on March 26, 2004. The Bankruptcy Court and the appellate courts, the BAP and the Court of Appeals for the Ninth Circuit, had jurisdiction under 28 U.S.C. § 157(b)(1).

The Court of Appeals' decision was issued January 28, 2010. (App. 1.) It has not been modified. "Cases in courts of appeal may be reviewed by the Supreme Court by . . . writ of certiorari granted upon petition of any party to a civil action . . . after rendition of judgment." 28 U.S.C. § 1254(1).

Here, the Court of Appeals' decision affirmed a published decision by the BAP that reversed a judgment in favor of Chase and against Taxel in the bankruptcy adversary proceeding by the United States Bankruptcy Court, Southern District of California, John J. Hargrove, Bankruptcy Judge. (App. 1-5, 16, 17-20, 36-37, 38-49.)

STATUTORY PROVISIONS INVOLVED

11 U.S.C. § 544(a)(3) defines the strong-arm or transfer avoiding powers of a bankruptcy trustee as:

> "(a) the trustee, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor of any obligation incurred by the debtor that is voidable by –
>
> . . .
>
> (3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists."

This law allows the trustee to avoid a transfer of real property by a debtor that is not perfected and

enforceable under applicable state law against a hypothetical bona fide purchaser from the debtor as of the instant the bankruptcy petition is filed. See *Briggs v. Kent (In re Professional Investment Properties of America)*, 955 F.2d 623, 627, cert. denied, 506 U.S. 818, rehearing denied, 506 U.S. 1015 (9th Cir. 1992). A bankruptcy trustee's status as a bona fide purchaser of real property is controlled by the substantive law of the state where the property is located. *Professional Investment* at 627; *Wolf v. Mahrdt (In re Chenich)*, 100 B.R. 512, 513, 514 (9th Cir. BAP 1987).

In *Professional Investment*, a creditor's involuntary bankruptcy petition listed a note owed by the debtor secured by an unrecorded deed of trust against real property. See *Professional Investment* at 625, 628. The Court of Appeals for the Ninth Circuit held that a debtor's bankruptcy petition may give inquiry or constructive notice to a bankruptcy trustee of an unrecorded interest in a debtor's real property, under the law of the state where the property is located, that is sufficient to defeat a trustee's status as a hypothetical bona fide purchaser under 11 U.S.C. § 544(a)(3). See *Professional Investment* at 627-629.

The applicable state law on inquiry or constructive notice of transfers of real property is California Civil Code § 19 because the real property

here was located in California.[1] This statute provides that:

> "Every person who has actual notice of circumstances sufficient to put a prudent man upon inquiry as to a particular fact, has constructive notice of the fact itself in all cases in which, by prosecuting such an inquiry, he might have learned such fact."

The California Supreme Court has held that a purchaser of real property has not only constructive notice of the contents of a recorded document, but inquiry or constructive notice of all matters stated or referred to in the recorded document, including matters in other unrecorded documents and matters in those documents. See *Lent v. Morrill,* 25 Cal. 492, 500, 501 (1864); *Newhall v. Hatch,* 134 Cal. 269, 275 (1901); *Buehler v. Oregon-Washington Plywood Corp.,* 17 Cal.3d 520, 529, 530 (1976); see also, e.g., *Dexter v. Pierson,* 214 Cal. 247, 250, 251 (1931).

FACTUAL STATEMENT

The facts here are all undisputed. The debtor, Deuel, and her former husband, Will Deuel, purchased a condominium in Santee, California, a

[1] *Professional Investment* construed Washington law on inquiry or constructive notice of transfers of real property. That law is identical to California law on such notice. Cf. *Professional Investment* at 627 to California Civil Code § 19.

suburb of San Diego, on October 21, 1999. They financed their purchase with a $106,700 loan secured by a deed of trust against the property recorded the same day. In 2001, the Deuels refinanced the loan with a $122,400 loan secured by a new recorded deed of trust. They used some of the proceeds of this loan to pay off the loan they used to purchase the property. The new $122,400 loan and deed of trust were then assigned to Chase. On September 4, 2002, the Deuels refinanced this loan with a new $136,000 loan from Chase that was to be secured by a new deed of trust recorded against the property. They used $121,256 in loan proceeds to pay off Chase's existing $122,400 note and used $6,986 to pay credit card debts.

The problem, that resulted in this lawsuit, is that the new $136,000 Chase deed of trust was, by mistake, never recorded. It should have been recorded on September 4, 2002. The existing $122,400 Chase deed of trust was reconveyed on September 26, 2002, with Chase mistakenly not realizing its new $136,000 deed of trust had not been previously recorded. Thus, as far as anyone could tell from the county records, the Chase loan against the condominium had been paid off and there was no longer a deed of trust or lien against it.

The next year, in 2003, Deuel filed a chapter 13 bankruptcy. Her petition, schedules and statement of affairs were filed electronically at the same instant. They told a different story than what the county records showed, the absence of the $136,000 Chase loan and the deed of trust against the condominium

that secured the loan – that there was a $136,000 security interest in favor of Chase that was a lien against the property. Deuel's schedules and statement of affairs included a comprehensive description of the $136,000 Chase loan and the deed of trust that secured it. In her schedules, she listed the condominium with a value of "$215,000" subject to a secured claim of $137,575 owed to Chase. She also listed the Chase note of $136,000 and stated it was "incurred 2002 lien, deed of trust, security, 9236 Mast Boulevard, # 17, Santee, California 92071." Deuel included this identical information in her statement of affairs. The chapter 13 case was dismissed on the motion of the trustee in that case in October 2003.

Six months later, on March 26, 2004, Deuel again filed for bankruptcy, this time a chapter 7. Like the earlier chapter 13 bankruptcy, her petition, schedules and statement of affairs were all electronically filed at the same instant and, once more, stated something different about the current title to the condominium than what the county records showed (no deed of trust against it). Again, in the schedules and statement of affairs, she listed the Chase loan and deed of trust as a secured debt against the condominium; the property having a value of $245,000 and an unpaid balance due to Chase of $134,165.

Deuel's voluntary petition was on Official Form 1, as required. And, also as required, she listed in the petition her prior chapter 13 bankruptcy, as a bankruptcy filed within the last six years: "Southern Dist. of CA, Case Number 03-6054-B13, date filed,

6/27/2003." In addition, and as required by Bankruptcy Rule 1007(a)(1), she electronically filed "with the petition" the list of secured and unsecured creditors, listing "Chase Manhattan Mortgage." See Federal Rules of Bankruptcy Procedure, Rule 1007. This information was also different from what the county records showed, that the Chase loan had not been paid off and Deuels still owed Chase the money.

The Bankruptcy Court's docket entry no. 1 described Deuel's electronic filing of her petition, schedules and statement of affairs as one event. Docket entry no. 3 described the appointment of the respondent, Taxel, as the trustee for the bankruptcy.

PROCEDURAL HISTORY

Chase filed the adversary proceeding against Taxel for quiet title to Chase's security interest in the condominium under the $136,000 deed of trust, effective September 4, 2002, and for a judgment the Chase deed of trust encumbered the property and was senior in priority to any interest of the trustee. Taxel filed a motion to dismiss/for summary judgment on the complaint, contending the trustee was a bona fide purchaser without notice, under California law, of the unrecorded Chase deed of trust under 11 U.S.C. § 544(a)(3), so, Chase could not state a valid claim that its security interest in the property under its deed of trust was senior to the estate or interest of the trustee.

Chase opposed the motion and filed a cross-motion for summary judgment. It contended that since Deuel's concurrently filed schedules and her earlier chapter 13 bankruptcy stated the condominium was encumbered by the Chase deed of trust, the trustee, under California law, Civil Code § 19, and the holding in *Professional Investment* had inquiry or constructive notice of Chase's deed of trust and was not, as a matter of law, a bona fide purchaser under section 544(a)(3). As an alternative, Chase contended that because $121,256 of its $136,000 loan was used by Deuel to pay off an earlier $122,400 recorded Chase deed of trust, the interest of Chase in that earlier deed of trust, under the doctrine of equitable subrogation, was, to the extent of at least $121,256, senior to any interest of the trustee in the property.

The Bankruptcy Court agreed with Chase. It found that *Professional Investment* applied, so Taxel was not a bona fide purchaser under 11 U.S.C. § 544(a)(3). The Court also ruled that under the doctrine of equitable subrogation, the trustee's interest in the property was subrogated to the earlier $122,400 recorded Chase deed of trust because the $136,000 loan Deuel obtained in September 2002 was used to satisfy the earlier loan. (App. 45-49.)

The Court denied Taxel's motion to dismiss/for summary judgment and granted Chase's cross-motion for summary judgment. (App. 41-44.) A judgment was entered quieting title to Chase's security interest in the condominium under its $136,000 deed of trust, effective September 4, 2002, the date the deed of trust

should have been, but was not, by mistake, recorded. (App. 38-40.)

Taxel appealed the judgment to the BAP, who reversed it. (App. 17-20, 36-37.) They held that *Professional Investment*, while a correct statement of the law, nonetheless, did not apply, reasoning that Deuel's petition was a separate document from the schedules which contained no reference to the Chase deed of trust and came too late to provide the trustee with inquiry or constructive notice of the unrecorded deed of trust. Thus, the petition did not impart such notice under California law of the Chase deed of trust to the trustee and, as a matter of law, the trustee was a bona fide purchaser of the condominium with an interest senior to Chase under 11 U.S.C. § 544(a)(3). (App. 26-32.) Chase's equitable subrogation theory was also rejected by the BAP because of Taxel's bona fide purchaser status under section 544(a)(3). (App. 32-36.)

Chase appealed the BAP decision to the Court of Appeals for the Ninth Circuit. The Court of Appeals, in a decision filed January 28, 2010, agreed with the BAP's decision and reasoning. (App. 7-16.) It affirmed the decision and reversed the Bankruptcy Court's order granting Chase's summary judgment motion and denying Taxel's motion to dismiss/for summary judgment on Chase's adversary proceeding. No petition for rehearing was filed.

REASONS FOR GRANTING THE WRIT

1. A Bankruptcy Trustee's Hypothetical Bona Fide Purchaser Status And The Ability To Avoid Transfers Of A Debtor's Real Property Under 11 U.S.C. § 544(a)(3) Should Be Determined By Information About The Property Contained In A Chapter 7 Bankruptcy Petition And/Or A Debtor's Required Schedules That Are Electronically Filed At The Same Instant As The Petition.

a. A Bankruptcy Trustee's Avoiding Power, As Defined In 11 U.S.C. § 544(a)(3), Is An Important Federal Question.

As described above, 11 U.S.C. § 544(a)(3) gives a bankruptcy trustee, as of the commencement of a case, the status of a hypothetical bona fide purchaser of a debtor's real property under the laws of the state where the property is located, and with this status, the power to avoid unperfected transfers of the property. See 11 U.S.C. § 544(a)(3); *Professional Investment* at 627. The Revision Notes and Legislative Report on section 544 describe subsection (a) as "the strong-arm clause" empowering a bankruptcy trustee to avoid certain transfers of a debtor's property.

The present case determined the extent of a bankruptcy trustee's avoiding powers as a bona fide purchaser under 11 U.S.C. § 544(a)(3). This is, undoubtedly, an important question of federal law.

b. The Supreme Court Has Not Ruled On The Extent Of The Strong-Arm Powers Of A Bankruptcy Trustee As A Bona Fide Purchaser Of Real Property To Avoid Transfers Under 11 U.S.C. § 544(a)(3).

The Supreme Court has not yet construed section 544(a)(3), that defines the extent of a bankruptcy trustee's avoiding powers as a hypothetical bona fide purchaser of a debtor's real property. The Court has interpreted the purpose of another statute conferring transfer avoiding powers on a bankruptcy trustee, 11 U.S.C. § 547, as a "mechanism [that] prevents the debtor from favoring one creditor over the other by transferring property shortly before filing Bankruptcy." See *Begier v. I.R.S.*, 496 U.S. 53, 58 (1990). This decision also held that "equality of distribution among creditors is a central policy of the Bankruptcy Code." *Id.* at 58.[2]

The only published United States Court of Appeals' decisions about whether a debtor's bankruptcy petition can impart inquiry, and in turn, constructive notice of an interest in real property to a hypothetical bona fide purchaser, the bankruptcy

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[2] It is undisputed nothing of the sort happened here. Nor was there as much as an implied suggestion that the debtor, Deuel, and Chase manipulated things to keep assets from creditors, or to prefer Chase over other creditors. It was just the opposite. Deuel always treated the condominium as encumbered by a first deed of trust and used the loan proceeds from the $136,000 Chase loan and the earlier refinance to pay off previous first loans and to pay off unsecured credit card debts.

trustee, and thus defeat this status conferred by section 544(a)(3), is *Professional Investment* and the present case. This Court denied certiorari and a request for rehearing in *Professional Investment*. See *Professional Investment*, cert. denied, 506 U.S. 818, rehearing denied, 506 U.S. 1015.

c. This Court Should Decide The Question Of Whether A Bankruptcy Petition And/Or A Debtor's Concurrently Filed Schedules Can Impart Constructive Notice To A Bankruptcy Trustee Of An Interest In Real Property.

Professional Investment, consistent with numerous other cases construing a trustee's hypothetical bona fide purchaser status under section 544(a)(3), determined the existence of such status by treating the trustee like any other prudent prospective purchaser of real property, and examining whether the trustee, as of the instant the case was commenced, possessed facts putting the trustee on inquiry or constructive notice of an interest in a debtor's real property. See *Professional Investment* at 627-629; see also, e.g., *Placer Savings & Loan Assoc. v. Walsh (In re Marino)*, 813 F.2d 1562, 1565 (9th Cir. 1987); *Siegel v. Boston (In re Sale Guaranty Corp.)*, 220 B.R. 660, 666 (BAP 9th Cir. 1998), affirmed, 199 F.3d 1375 (9th Cir. 2000) and *Weisman v. Peters (In re Weisman)*, 5 F.3d 417, 421 (9th Cir. 1993) (actual possession of real property by a person that is inconsistent with record ownership when a case is

commenced may put a trustee on inquiry or constructive notice under California law of that person's interest in the property sufficient to defeat hypothetical bona fide purchaser status under section 544(a)(3)).

The principle announced in these four cases (and many others construing section 544(a)(3)) is that the bankruptcy trustee has constructive notice, or inquiry notice that is the equivalent of constructive notice, of all facts or matters concerning a debtor's real property that any other prospective purchaser would have from examining the property itself and the public records as they existed simultaneously with the filing of the bankruptcy. *Professional Investment* held that a diligent title search would have disclosed a bankruptcy filing. See *Professional Investment* at 627. Since the bankruptcy petition in that case described the unrecorded deed of trust, the trustee, simultaneously with the bankruptcy filing, was put on inquiry or constructive notice of the deed of trust. *Id.* at 627-629.

The BAP and the Court of Appeals departed from this guiding principle in the present case. Equally important, they ignored the realities of electronic transmission of documents, or efiling of pleadings or documents, and how this technology, in actuality, impacts the knowledge a trustee obtains the instant a bankruptcy petition is filed. They determined that a chapter 7 petition simultaneously filed at the same instant, via efiling, with the debtor's schedules was, nonetheless, something that occurred before the

schedules were filed, because the petition and schedules are different pleadings on different official forms and the schedules can only be filed once there is a "case." (App. 8-14.)

The Court of Appeals bolstered its conclusion by reasoning the simultaneously appointed bankruptcy trustee was a metaphysical person, not a real one, who did not yet exist until the case was commenced.[3] This was correct, but only until the bankruptcy petition and debtor's schedules were filed. These events occurred simultaneously, as did the appointment and creation of the bankruptcy trustee, whose metaphysical form was instantly transformed into that of a real person. That real person, as well as the metaphysical one, in reality, had knowledge of every fact or matter concerning the debtor's real property that existed at the same instant these three events happened, the filing of the petition, the filing of the schedules and the creation and appointment of the trustee.

Simultaneous means "occurring, done, existing, etc. together or at the same time." See Webster's New World Dictionary (3d College Edition) p. 1251. The electronic transmission and filing of two official court forms, a bankruptcy petition and debtor's schedules, has to fit this definition. The Bankruptcy Court's

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[3] Webster's defines metaphysical as "beyond the physical or material; incorporeal." See Webster's New World Dictionary (3d College Edition) p. 853.

docket shows this was treated as a single event. Why? Because, in actuality, it was.

Instantaneous electronic transmission of the written word for everyday communications between people and for all manner of business transactions, such as securities, currency and money, real estate, etc., has become universal. The federal court system has adopted the widespread use of electronic or efiling in numerous districts and circuits. The Southern, Central and Northern districts of California mandate efiling, as does the Court of Appeals for the Ninth Circuit. Thus, the issue of the legal effect of electronic transmission technology, for example, the simultaneous electronic transmission of multiple documents or, like here, the simultaneous efiling of multiple pleadings, will continue to be an issue businesses, persons and courts, and certainly bankruptcy courts, as well as bankruptcy trustees, debtors and creditors, will encounter and have to deal with, as they did in the present case.

Only here, the Court of Appeals imposed a standard for determining the legal effect of the simultaneous electronic transmission and filing of documents that ignores the practical and actual effect of this technology and what really happened. It is undisputed that the filing of the bankruptcy petition and the debtor's schedules, as well as the creation and appointment of Taxel as the bankruptcy trustee and hypothetical bona fide purchaser, all occurred at the same moment in time because of the simultaneous electronic filing of the two official court

forms. Not so, says the Court of Appeals. Simultaneous does not mean what it really means, or like baseball legend Yogi Berra once said, "I didn't really say the things I said."

Simultaneous should always mean what Webster's says it means. If so, it follows that the legal standard for determining the extent of the inquiry or constructive notice attained by a bankruptcy trustee, as the hypothetical bona fide purchaser of a debtor's real property under 11 U.S.C. § 544(a)(3), at the moment the bankruptcy petition was filed and the trustee/hypothetical bona fide purchaser sprang into existence, should be based on the true meaning of simultaneous and the actual and real world effect of the simultaneous electronic transmission and filing of multiple documents and what those documents revealed to the trustee and to any hypothetical bona fide purchaser of real property. If it is, then, like the trustee in *Professional Investment*, the bankruptcy petition and the schedules put Taxel on inquiry or constructive notice of the Chase deed of trust.

After all, such a holding finds support in Court of Appeals' decisions construing how to determine a bankruptcy trustee's knowledge as a hypothetical bona fide purchaser at the moment a bankruptcy petition is filed. *Professional Investment* held that matters stated in the bankruptcy petition that created the trustee could impart inquiry or constructive notice to the trustee of matters affecting title to a debtor's real property. See *Professional Investment* at 627-629. Actual possession of a debtor's

real property by a person in a manner inconsistent with record title at the time the case was commenced was sufficient to put a bankruptcy trustee on inquiry or constructive notice of that person's interest in the property. See *Sale Guaranty Corp.* 666; *Weisman* 421. A bankruptcy trustee is also deemed to have conducted a title search of real property and is subject to constructive notice, or inquiry notice that is the equivalent of constructive notice, of matters affecting title to a debtor's real property. See 5 A. Resnick & H. Sommer, Collier on Bankruptcy ¶¶ 544.03, 544.08, pp. 544-9, et seq.

The Bankruptcy Rules support such a holding. The Court of Appeals gave another reason to treat a petition as filed "before" a debtor's schedules (despite the fact both documents were filed at the same instant as one file). This was because Bankruptcy Rule 1007(b) allows the debtor to file schedules 15 days after a petition is filed. See F.R.B.P. Rule 1007(b). That rule, however, also states "the debtor shall file **with the petition** a list containing the name and address of each entity included or to be included on Schedules D, E [secured and unsecured creditors]." See F.R.B.P. Rule 1007(a)(1) (Emphasis added.) The word "with," used in this way, has the definition of "accompanied by." See Webster's New World Dictionary (3d College Edition) p. 1534.

The list of secured and unsecured creditors Deuel filed with her petition listed "Chase Manhattan Mortgage" as a creditor. If, as *Professional Investment* correctly holds, that a bankruptcy trustee is properly

charged with inquiry or constructive notice of information contained in a petition, it naturally follows the trustee should be charged with notice of information about a debtor included in the list of creditors the Bankruptcy Rules require a debtor to file "with the petition." See *Professional Investment* at 627-629; see also F.R.B.P. Rule 1007(a)(1).

A bankruptcy trustee, for purposes of gauging the power conferred by section 544(a)(3) to avoid transfers of a debtor's real property, should be charged with notice of information that existed concerning the property at the same instant the trustee was appointed. The Court of Appeals here ignored what actually happened. They honored form over substance.[4] They have set the wrong precedent by imposing an artificial standard for determining the extent of the knowledge the bankruptcy trustee as a hypothetical bona fide purchaser had at the commencement of the case.

The Court held that a bankruptcy petition and a debtor's schedules that were, without a doubt, filed at the same instant the trustee was appointed, really were not, so information contained in the schedules could not put the trustee on inquiry or constructive notice of matters affecting title to the debtor's real property as of the commencement of the case under

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[4] In so doing, the Court violated a universally accepted maxim of jurisprudence that, "[t]he law respects form over substance." See California Civil Code § 3528.

11 U.S.C. § 544(a)(3). The standard should be the opposite. The information in a petition and schedules (and the list of creditors) electronically filed at the same instant as one file is information about the debtor and the debtor's property that existed "as of the commencement of the case," not after, and should be properly considered under section 544(a)(3) to determine the trustee's status as a bona fide purchaser of a debtor's real property.

The strong-arm or transfer avoiding powers of a bankruptcy trustee under 11 U.S.C. § 544(a)(3) and whether simultaneously filed pleadings may affect the trustee's status as a hypothetical bona fide purchaser are important federal questions. This is especially the case in these continuing hard economic times with an increased number of personal and business bankruptcy filings and the mortgage loan meltdown.

Debtors, creditors, trustees and the courts need a real world standard that recognizes how the technology of the simultaneous electronic transmission of documents may impact the inquiry or constructive notice a bankruptcy trustee as a hypothetical bona fide purchaser has at the commencement of a bankruptcy case. The contrived and artificial standard created by the appellate courts below is not the answer. Review is appropriate and necessary to decide this timely and important question of bankruptcy law.

2. The United States Court Of Appeals For The Ninth Circuit Has Interpreted The Scope And Meaning Of 11 U.S.C. § 544(a)(3) And A Bankruptcy Trustee's Avoiding Powers As A Hypothetical Bona Fide Purchaser Of Real Property Under This Statute In A Way That Abrogates Or Conflicts With California Supreme Court Decisions On The Issue Of When And How A Prospective Purchaser Of Real Property In California Is Put On Inquiry Or Constructive Notice Of Facts Affecting Title To Real Property.

a. The Correct Application Of State Law Is Essential To Proper Enforcement Of 11 U.S.C. § 544(a)(3).

Section 544(a)(3) specifically defines a trustee's hypothetical bona fide purchaser status as "a bona fide purchaser of real property . . . from the debtor, against whom applicable law permits such transfer to be perfected." This language means federal courts must apply the substantive law of the state where the real property is located to determine whether a bankruptcy trustee is a bona fide purchaser of a debtor's real property with the power to avoid transfers of the property under section 544(a)(3). See *Professional Investment* at 627.

Thus, the correct application of state law, here California law, on what amounts to inquiry or constructive notice by a purchaser of real property of matters affecting title to real property, is essential

to proper enforcement by a Bankruptcy Court of a trustee's avoiding powers conferred by section 544(a)(3).

b. The California Supreme Court Has Held That Prospective Purchasers Of Real Property Have Inquiry Or Constructive Notice Of Matters In Unrecorded Documents That Are Referred To In Recorded Documents.

The applicable state law defining inquiry notice is California Civil Code § 19 (set forth above) which provides that a person's knowledge of facts sufficient to incite inquiry is constructive notice of all that the inquiry would have disclosed. See California Civil Code § 19. The California Supreme Court, in construing this statute, has held that a purchaser of real property has constructive notice of matters in unrecorded documents that are referred to in recorded documents and inquiry notice, under Civil Code § 19, of information in the unrecorded documents that a reasonable inquiry would have disclosed. See, e.g., *Lent* at 500, 501; *Newhall* at 275; *Buehler* at 529, 530.

An example of this principle are unrecorded promissory notes secured by recorded mortgages or deeds of trust against real property where the note is specifically referred to in the mortgage or deed of trust. The California Supreme Court has held that where a mortgage or deed of trust states it secures a promissory note and all extensions or renewals of the note, a subsequent purchaser of the real property is put on inquiry notice of a possible off-record extension

or renewal of the note. See *Lent* at 500, 501; *Newhall* at 275; see also, e.g., *Dexter* at 250, 251 (waiver of statute of limitations on one-year note).

Since a purchaser of real property has notice of the contents of not only a recorded document, but of other documents referred to in it, the two documents must be read and construed together. See, e.g., generally, Miller and Starr, California Real Estate (2010) § 11:61. *Buehler,* another California Supreme Court case, illustrates how far this principle of inquiry notice has been extended to purchasers of real property in California.

In *Buehler*, the ambiguities in a recorded easement for a logging road left room for a reasonable difference of opinion as to the extent and terms of the grant of the easement. The court held that a purchaser of the property burdened by the easement was put on inquiry or constructive notice of such ambiguities and took title subject to what a reasonable inquiry about the ambiguity would have revealed, including, an unrecorded side agreement and competing claims under the easement. See *Buehler* at 529, 530. *Buehler* was a case of first impression and, at present, is the final word of the California Supreme Court on the extent to which a purchaser of real property in California has notice of the contents of not only a recorded document, but of other documents or matters referred to in the recorded document, including ambiguities in the language of that document, that put a purchaser on

inquiry or constructive notice of matters affecting title to the property.

c. The Court Of Appeals' Decision Abrogates And Conflicts With California Supreme Court Decisions On When A Purchaser Of Real Property Has Inquiry Or Constructive Notice Of Matters Affecting Title To Real Property.

After determining the debtor's schedules came too late to impart inquiry or constructive notice of the Chase deed of trust, the Court of Appeals then applied California law on this issue, California Civil Code § 19, to determine if Taxel had any facts to put him on inquiry or constructive notice of the unrecorded Chase deed of trust. The decision that Taxel did not have such notice directly conflicts with and abrogates California Supreme Court decisions that have set the precedent in California for determining if a prospective purchaser of real property has inquiry or constructive notice of matters affecting title to real property. See *Lent* at 500, 501; *Newhall* at 275; *Buehler* at 529, 530.

Both the BAP and the Court of Appeals emphasized that, like *Professional Investment*, "only the ramifications of the petition itself" could be properly examined to determine if the trustee had inquiry or constructive notice of a matter affecting title to a debtor's real property. See *Professional Investment* at 628, fn. 3. Here the bankruptcy petition, under the holding in *Professional Investment*,

construed by applicable state law in California, the California Supreme Court decisions in *Lent*, *Newhall* and *Buehler*, imparted inquiry or constructive notice of the unrecorded Chase deed of trust.

The Bankruptcy Rules require a petition to be filed on Official Form 1. That form has instructions and spaces for and requires a debtor to list in the petition on page 2 all bankruptcies filed within the last six years. The purpose for this is self-evident from the Bankruptcy Code. If a debtor had been granted a discharge in a previous bankruptcy, 11 U.S.C. § 727(a)(9) would prevent the debtor from obtaining a discharge in the new case. Similarly, if a previous bankruptcy by an individual had been dismissed in the 180 days preceding the filing, "for a willful failure of the debtor to abide by an order of the court," that individual may not be a chapter 7 debtor in the new case. See 11 U.S.C. § 109(g)(1). The earlier bankruptcy may also reveal transfers of a debtor's property that occurred before the chapter 7 filing and how the debtor's financial affairs may have changed over the previous nine months. Thus, when a debtor lists a previous bankruptcy in a petition, this fact is sufficient to incite an inquiry by a bankruptcy trustee into everything that occurred in that bankruptcy.

Here, the debtor, Deuel, followed the rules. She listed in her new petition the 2003 chapter 13 bankruptcy filed just nine months earlier. Under the reasoning in *Professional Investment*, as well as that of BAP and the Court of Appeals in the present case, the very petition that commenced the case ("the ramifications of the petition itself") put Taxel on

inquiry notice of what occurred in the first bankruptcy. The California Supreme Court holdings construing California Civil Code § 19, mean Taxel would be charged at the commencement of a case with constructive notice of all that a reasonable inquiry by him into the chapter 13 bankruptcy would have revealed. See, e.g., *Lent* at 500, 501; *Newhall* at 275; *Buehler* at 529, 530. The debtor's schedules in the earlier bankruptcy revealed what the county records on Deuel's condominium did not show – that Chase did have a deed of trust against that property that secured a $136,000 loan owed by her to Chase that had not been paid off. Her statement of affairs stated the same thing.

The California Supreme Court decisions in *Lent* and *Newhall* held that if a recorded document refers to another off-record document, in these cases, promissory notes secured by deeds of trust, a purchaser of real property subject to the deed of trust is charged with inquiry notice of the note and constructive notice of all matters concerning the terms and status of the notes that an investigation concerning the notes would have revealed. See *Lent* at 500, 501; *Newhall* at 275.

The most recent California Supreme Court decision on the same subject, *Buehler*, was based on this same principle – a purchaser with constructive notice of a document "is charged with notice of all matters stated or referred to in such conveyance, which may possibly affect title, and [he] is bound to make any inquiries or researches suggested by such statements or references." See *Buehler* at 529. In this

case, the language in an easement for a road revealed there might be limitations on the scope and use of the easement. *Id.* at 527, 528. The court held the purchaser was charged with inquiry or constructive notice of what an investigation into language of the easement would have revealed – and the off-record agreement that limited its use. *Id.* at 529, 530.

The Court of Appeals in the present case has abrogated this precedent. It held that a hypothetical bona fide purchaser of real property who has constructive notice of matters in a bankruptcy petition, the chapter 13 bankruptcy listed in the petition, was not put on inquiry notice, the equivalent of constructive notice, of all that this earlier bankruptcy would have revealed to Taxel concerning title to the debtor's real property, the existence of the Chase deed of trust. The Court decided an important federal question, the extent of a bankruptcy trustee's power under 11 U.S.C. § 544(a)(3) to avoid a transfer of an interest in a debtor's real property located in California, as determined by state law. However, the court did so in a way that conflicts with binding precedent by the California Supreme Court that defines who can be a bona fide purchaser of real property and the manner in which such a purchaser may be put on inquiry or constructive notice of matters affecting title to real property.

Congress, when it enacted 11 U.S.C. § 544(a)(3), expressly allowed the states and a state's substantive law defining a hypothetical bona fide purchaser of real property to control the bankruptcy trustee's

power to avoid a transfer of an interest in a debtor's real property located in that state. In the present case, this intent made the California Supreme Court decisions on the issue of inquiry or constructive notice and the definition of a hypothetical bona fide purchaser of real property paramount. Review by this Court is necessary to enforce Congress' intent and reverse the Court of Appeals' incorrect precedent that has abrogated California law where that law controls the federal question of the trustee's avoiding powers under section 544(a)(3).

CONCLUSION

The law should not impose an artificial, or as the Court of Appeals called it here, a metaphysical standard, to determine the information a hypothetical purchaser of real property has at a particular moment in time in the real world about matters affecting title to that property. A real world standard, where the electronic transmission of multiple documents and information at the same time provide simultaneous and instantaneous notice to a purchaser of real property about the property, should be the standard. Nowhere is such a standard more important than determining a bankruptcy trustee's section 544(a)(3) avoiding powers over a debtor's real property transactions.

By the same token, where state law controls a federal question, federal appellate court decisions

should not abrogate state law. Review should be granted to set the more logical and correct standard for determining a bankruptcy trustee's status as hypothetical bona fide purchaser under 11 U.S.C. § 544(a)(3) and to reverse the Court of Appeals' decision that has set an incorrect precedent that conflicts with California law for determining such status.

Dated: April 28, 2010

JAMES C. MITCHELL*
MITCHELL | GILLEON LAW FIRM
1320 Columbia Street, Suite 200
San Diego, CA 92101
Tel: 619.702.8623
Fax: 619.702.6337
Email: jcm@mglawyers.com

Attorneys for Petitioner
Chase Manhattan Bank, USA, N.A.
**Counsel of Record*

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In the Matter of: JILL C. DEUEL, *Debtor*, CHASE MANHATTAN BANK, USA, N.A., *Appellant*, HAROLD S. TAXEL, Trustee, *Appellee*.	No. 07-55266 BAP Nos. SC-06-01063- MoSnK SC-06-01132- MoSnK OPINION

Appeal from the Ninth Circuit
Bankruptcy Appellate Panel
Klein, Montali, and Snyder,
Bankruptcy Judges, Presiding

Argued September 11, 2008 and
Submitted September 29, 2009

Pasadena, California

Filed January 28, 2010

Before: Alex Kozinski, Chief Judge, Andrew J. Kleinfeld and Johnnie B. Rawlinson, Circuit Judges.

Opinion by Judge Kleinfeld

SUMMARY

Bankruptcy/Claims

The court of appeals affirmed a decision of the Bankruptcy Appellate Panel. The court held that,

under California law, a bankruptcy trustee, as a bona fide purchaser of the debtor's real property for value without notice of a bank's unrecorded deed of trust, properly avoided transfer of the debtor's property to satisfy the bank's lien, despite the debtor's having disclosed the existence of that lien in the schedule that she filed contemporaneously with her bankruptcy petition.

Appellee Harold Taxel was the trustee for debtor Jill Deuel's Chapter 7 bankruptcy. Appellant Chase Manhattan, which held an unrecorded deed of trust encumbering Deuel's California condominium and securing its loan, filed a complaint in bankruptcy court in California to quiet title to its lien. The bankruptcy court ruled in Chase Manhattan's favor, on the theory that under the Ninth Circuit's decision in *Briggs v. Kent* (*In re Professional Investment Properties. of America*), Deuel's schedule disclosing the existence of the deed of trust, which was filed contemporaneously with her petition, provided constructive notice to Taxel of Chase Manhattan's unrecorded lien. Alternatively, the bankruptcy court concluded that Chase Manhattan was subrogated to its own previously recorded lien on the same property because it had used the subsequent loan to pay it off. The Bankruptcy Appellate Panel reversed, ruling in Taxel's favor, distinguishing *Professional Investment*, and rejecting the subrogation theory.

Chase Manhattan appealed.

Under 11 U.S.C. § 544(a), a bankruptcy trustee has the power to avoid any transfer that a hypothetical bona fide purchaser for value could have avoided "as of the commencement of the case" under the law of the state in which the real property is located. As the Bankruptcy Appellate Panel correctly pointed out, the schedules must be filed in a case, which exists only after the filing of a petition has "commenced" a case, so whatever Taxel may have learned from the schedules and statement of financial affairs filed by Deuel came too late and was irrelevant, even though Deuel filed her schedule contemporaneously with her bankruptcy petition. Under § 544(a), the bankruptcy trustee's "strong arm power" to avoid a transfer exists without regard to any knowledge of the trustee.

By its terms, *Professional Investment* was limited to involuntary petitions that give notice of an interest; it had no application to a voluntary petition like Deuel's. The Bankruptcy Appellate Panel was correct in distinguishing *Professional Investment*.

A fundamental purpose of bankruptcy is fair distribution of a debtor's inadequate assets pro rata within the classes of creditors determined by Congress. That purpose could be defeated if a debtor were able to jump an unrecorded security interest over the trustee's status on behalf of other creditors by mentioning it when the debtor filed the petition.

California law provides that a conveyance, from the time it is filed with the recorder for record, is constructive notice of the contents thereof to subsequent

purchasers and mortgagees. Chase Manhattan did not record, so the trustee did not have constructive notice of its lien. Under California law, a conveyance is void as against any subsequent purchaser whose conveyance is first duly recorded. The strong arm clause enables the trustee to avoid an unrecorded lien as if he were a bona fide purchaser of real property from the debtor who has perfected such transfer at the time of the commencement of the case. Under California law, Taxel had to be deemed not only to have purchased the property for value without notice of the unrecorded lien, but also to have recorded his deed when the bankruptcy petition was filed. This presumed recording rendered Chase Manhattan's lien void.

Chase Manhattan offered an alternative theory, equitable subrogation, according to which, if a junior lienor pays off a senior lien, it may be subrogated to the senior lienor's position against other creditors, most typically when a surety pays its principal's obligation and steps into the principal's shoes against third parties. There were three reasons why Chase Manhattan could not rely on the theory of equitable subrogation. First, the creditor whose debt it paid off itself had no lien, having discharged it by a recorded deed of reconveyance. Second, enforcement of Chase Manhattan's right of subrogation would work an injustice by jumping Chase Manhattan over other creditors who might have extended credit without record notice of Chase Manhattan's unrecorded lien. Third, California courts give priority to a bona fide purchaser

over one claiming equitable subrogation. The judgment of the district court had to be affirmed.

COUNSEL

James C. Mitchell, Mitchell & Gilleon, San Diego, California, for the appellant.

Michael Y. MacKinnon, Kathleen A. Cashman-Kramer, Pyle Sims Duncan & Stevenson, APC, San Diego, California, for the appellee.

OPINION

KLEINFELD, Circuit Judge:

We address the "strong-arm power" of the bankruptcy trustee under 11 U.S.C. § 544(a)(3) in the context of an unrecorded deed of trust. The question comes down to whether a bona fide purchaser for value without notice can take ahead of an unrecorded lien, and once the question is put that way, the answer is obviously "yes."

I. Facts

The case arises out of repeated home refinancing to take advantage of rising real estate values. Debtor Jill Deuel and her ex-husband Will Deuel bought a condominium in California in 1999. They borrowed $106,700 from North American Mortgage Company, secured by a duly recorded deed of trust. Two years

later, on June 6, 2001, they refinanced, this time borrowing $122,400 from American Mortgage Express Financial Corp., again secured by a duly recorded deed of trust. The Deuels used this loan to pay off the prior North American loan. This second loan was assigned to Chase Manhattan in May 2002, and the assignment was duly recorded.

The problem giving rise to this case arises from the Deuel's third loan, the second time they refinanced and drew more equity out of their condo, in 2002. This time they borrowed $136,000 from Chase Manhattan and gave Chase Manhattan a deed of trust to secure their note. Somehow Chase Manhattan failed to get the deed of trust recorded. What did get recorded was the deed of reconveyance from the previous loan, which was paid off in full out of the new loan. Thus as far as anyone could tell from the county records, the condo had been paid off and there was no longer a lien against it.

The next year, in 2003, Ms. Deuel filed for a chapter 13 bankruptcy. That case was dismissed on the motion of the chapter 13 trustee. A year later, in 2004, she again filed for bankruptcy, this time under chapter 7. This 2004 case is the one before us. The appellee, Taxel, is the trustee for Deuel's chapter 7 bankruptcy. Deuel filed electronically. Along with her petition, she filed her schedules, listing Chase Manhattan's secured debt.

Chase Manhattan filed a complaint to quiet title to its lien, and prevailed in Bankruptcy Court on the

theory that under our decision in *Briggs v. Kent* (*In re Professional Investment Properties. of America*)[1] her schedules provided constructive notice to the bankruptcy trustee of Chase Manhattan's unrecorded lien, and alternatively, that it was subrogated to its own previous recorded lien because it had used the new loan to pay it off. The Bankruptcy Appellate Panel reversed, ruling in favor of the trustee, distinguishing *Professional Investment,* and rejecting the subrogation theory.[2] Chase Manhattan appeals.

II. Analysis

We review the Bankruptcy Appellate Panel's decision de novo.[3] Our conclusion is that its reasoning is correct, and we affirm.

A. Trustee's Strong Arm Power.

A bankruptcy trustee has the power to avoid any transfer that a hypothetical bona fide purchaser for value could have avoided under the law of the state in which the real property is located. What matters to this case is when the hypothetical bona fide purchaser is treated as having hypothetically purchased the property for value. The statutory language gives

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[1] 955 F.2d 623 (9th Cir. 1992).

[2] *Taxel v. Chase Manhattan Bank, USA* (*In re Deuel*), 361 B.R. 509 (9th Cir. BAP 2006).

[3] *Beeler v. Jewell* (*In re Stanton*), 303 F.3d 939, 941 (9th Cir. 2002).

the answer "as of the commencement of the case."[4] The relevant portion of the statute says:

> (a) The trustee shall have, *as of the commencement of the case,* and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by –
>
> . . .
>
> (3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer *at the time of the commencement of the case,* whether or not such a purchaser exists.[5]

In this case the petition and the schedules were filed simultaneously by means of electronic filing. Does that mean that the trustee took with notice of the lien disclosed in the schedules? If we were talking about real people walking over to the bankruptcy court and looking at the documents, the answer would be yes, but we are not. As is often the case in property law, we speak not of the physical but of the metaphysical.[6]

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[4] 11 U.S.C. § 544(a).

[5] 11 U.S.C. § 544 (emphasis added).

[6] "For who shall interest us in contingent remainders or the Statute of Uses, while Chinese metaphysics remain unexplored?"

(Continued on following page)

The statute says that a chapter 7 bankruptcy is "commenced by the filing with the bankruptcy court of a petition,"[7] so the petition and only the petition commences the case, regardless of what else happens at the same time. As the Bankruptcy Appellate Panel explained, the schedules "cannot be filed until there is a case in which to file them."[8] The trustee has not even been appointed when the petition is filed, and could not possibly be a bona fide purchaser for value without notice upon the filing of the petition, but he is treated by the statute as though he were.

Chase Manhattan correctly argues that a real person buying the property and checking the court records would know from the schedules Deuel filed simultaneously with her petition that it had a lien. But we are talking about a metaphysical and not a real person. The trustee who is treated as a bona fide purchaser for value without notice as of the commencement of the case does not yet exist at the commencement of the case. The schedules may be filed simultaneously or within 15 days after the petition is filed,[9] and there is no reason to condition the

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Frederic W. Maitland, 1 Collected Papers 190 (Fisher ed. 1911, Cambridge Univ. Press) (quoted in Cornelius J. Moynihan, Introduction to the Law of Real Property 199 n.1 (1962)).

[7] 11 U.S.C. § 301(a). The statute was amended in 2005 by dividing the statute into subsections (a) and (b).

[8] *Deuel*, 361 B.R. at 515.

[9] Fed. R. Bankr. P. 1007(c).

trustee's strong arm power on whether they are filed earlier than they need to be.

As the Bankruptcy Appellate Panel correctly pointed out, the schedules must be filed "[i]n" a case, which exists only after the filing of a petition has "commenced" a case, so whatever the trustee may learn from the schedules and statement of financial affairs "came too late and is irrelevant" even though it was filed when the petition was filed.[10] The petition and schedules are on different official forms.[11] It cannot matter whether a hypothetical trustee who immediately read what was filed would have actual knowledge from the schedules of the lien, or even if the subsequently appointed trustee does have actual knowledge, because section 544 says that the strong arm power exists "without regard to any knowledge of the trustee."[12]

Chase Manhattan's argument rests on our decision in *Professional Investment*. That was an involuntary bankruptcy filed by a creditor, the very creditor that held the unrecorded deed of trust from the debtor.[13] The petition itself expressly referred to the deed of trust, because an involuntary petition requires the creditor filing it to state its name and

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[10] *Deuel*, 361 B.R. at 514-15.

[11] *Compare* Official Form 1 (voluntary petition) *with* Official Form 5 (involuntary petition).

[12] 11 U.S.C. § 544(a).

[13] *Professional Investment*, 955 F.2d at 625.

address, amount of claim, and nature of claim.[14] We held that because "the petition itself" gave notice of the lien to the trustee, the trustee could not be deemed a bona fide purchaser for value without notice.[15] We adopted the view that the trustee's status is determined "'at the instant the petition is filed,'" so "we will only discuss the ramifications of the petition itself,"[16] but held that where the trustee was put on notice "by the very petition"[17] he could not be said to take without notice.

By its terms, *Professional Investment* is limited to involuntary petitions that give notice of an interest. The not yet existing trustee, under *Professional Investment,* cannot be a hypothetical bona fide purchaser *without notice* when the petition is filed where the duly filled out form of the petition itself gives notice. The trustee is then like a purchaser *with* notice. We need not address the controversy[18] about whether *Professional Investment* was correctly decided, since it has no application to a voluntary petition. Voluntary and involuntary petitions operate

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[14] Official Form 5.

[15] *Professional Investment,* 955 F.2d at 627, 628.

[16] *Id.* at 628 n.3 (quoting *Saghi v. Walsh* (*In re Gurs*), 27 B.R. 163 (9th Cir. BAP 1983)).

[17] *Id.* at 628.

[18] *See Kohut v. Quicken Loans, Inc.* (*In re Wohlfeil*), 322 B.R. 302, 305-06 (Bankr. E.D. Mich. 2005); *cf. Little v. Duncombe* (*In re Duncombe*), 143 B.R. 243, 246 (Bankr. C.D. Cal. 1992) (characterizing *Professional Investment* as having found "a narrow exception" to Ninth Circuit law).

differently in many respects: one is filed by the debtor, the other by a creditor; one does not list claims, the other states what interest the creditor filing it has; the commencement of a voluntary case by a petition "constitutes an order"[19] (the automatic stay), but an involuntary petition does not.

The conclusion we reach is not based solely on literalism and metaphysics. It is practical. The Bankruptcy Appellate Panel correctly pointed out that if schedules could defeat the trustee's status as a bona fide purchaser for value without notice in a voluntary petition, a debtor could use simultaneous filing of petition and the schedules to favor one creditor over others. Sometimes creditors and debtors acting together before the bankruptcy have good reason to delay recording[20] and may have a continuing reason after filing to keep assets from other creditors. A fundamental purpose of bankruptcy is fair distribution pro rata within the classes of creditors determined by Congress of a debtor's inadequate assets.[21] That purpose could be defeated if a debtor were able to jump an unrecorded security interest over the trustee's status on behalf of other creditors by mentioning it when the debtor filed the petition.

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[19] 11 U.S.C. § 301(b).

[20] *See, e.g., Washburn & Roberts, Inc. v. Park East (In re Washburn & Roberts, Inc.)*, 795 F.2d 870, 874 (9th Cir. 1986) (Tang, J., dissenting).

[21] *Begier v. I.R.S.*, 496 U.S. 53, 58 (1990).

State law controls whether the trustee's status as a bona fide purchaser for value without notice defeats the rights of the person against whom the trustee seeks to assert his powers.[22] California law provides that a conveyance, "from the time it is filed with the recorder for record is constructive notice of the contents thereof to subsequent purchasers and mortgagees."[23] Chase Manhattan did not record, so the trustee did not have constructive notice of its lien. Under California law, a conveyance is "void as against any subsequent purchaser or mortgagee of the same property, or any part thereof, in good faith and for a valuable consideration, whose conveyance is first duly recorded."[24] The strong arm clause enables the trustee to avoid an unrecorded lien as if he were "a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case."[25] That means that we are to deem the trustee not only to have purchased the property for value without notice of the unrecorded lien, but also to have recorded his deed when the petition was filed. It is as though he were shopping for a place to live, saw a classified ad,

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[22] *Robertson v. Peters* (*In re Weisman*), 5 F.3d 417, 420 (9th Cir. 1993).

[23] Cal. Civ. Code § 1213.

[24] *Id.* § 1214.

[25] 11 U.S.C. § 544(a)(3).

bought the condo after doing a title search, and recorded the deed, all at the instant the petition was filed. Under California law, such recording would render Chase Manhattan's lien void.

B. Equitable Subrogation

Chase Manhattan offers an alternative theory, equitable subrogation. If a junior lienor pays off a senior lien, it may be subrogated to the senior lienor's position against other creditors, most typically when a surety pays its principal's obligation and steps into the principal's shoes against third parties.[26] Chase Manhattan would have us treat its current lien as subrogated to its own previous lien, since it used the money from the Deuels' third refinancing of their condominium to pay off its own loan from the second refinancing, and that note was secured by a recorded deed of trust.

Equitable subrogation traditionally enables "[o]ne who pays, otherwise than as a volunteer, an obligation for which another is primarily liable," to be "given by equity the protection of any lien or other security for the payment of the debt to the creditor," and to "enforce such security against the principal

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[26] *See, e.g., Mort v. United States*, 86 F.3d 890, 893-94 (9th Cir. 1996).

debtor or collect the obligation from him."[27] California has adopted the traditional doctrine.[28]

Equitable subrogation does Chase Manhattan no good for three reasons. First, the creditor whose debt it paid off, itself has no lien, having discharged it by a recorded deed of reconveyance. Though there may be circumstances where a lien can be revived, they do not pertain where revival would prejudice senior or equal equities.[29] Second, "the right to subrogation will not be enforced to the injury of those having the legal title and an equal equity."[30] The California phrasing is that the doctrine only operates where it does "not work any injustice to the rights of others."[31] Equitable subrogation cannot operate here, because the trustee is treated as though he were a bona fide purchaser for value without notice of Deuel's condominium, later surprised by an unrecorded lien based on a discharged lien claimed by Chase Manhattan. A bona fide purchaser for value of the Deuel condo would learn from a title search that Chase Manhattan had discharged its lien, not that it still had one.

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[27] McClintock on Equity 332 (2d ed. 1948).

[28] *See Golden Eagle Ins. Co. v. First Nationwide Financial Corp.*, 31 Cal. Rptr. 2d 815, 821 (Cal. Ct. App. 1994).

[29] *Lawyers Title Ins. Corp. v. Feldsher,* 49 Cal. Rptr. 2d 542, 546 (Cal. Ct. App. 1996).

[30] McClintock on Equity 334.

[31] *Golden Eagle,* 31 Cal. Rptr. 2d at 821.

No court would burden a home buyer with paying off some creditor of the seller who had not recorded a lien, much less one who had recorded discharging a lien, and the trustee is deemed by section 544 to be in the position of that home buyer. Here equitable subrogation would work an injustice, by jumping Chase Manhattan over other creditors who may have extended credit without record notice of Chase Manhattan's unrecorded lien.

Third, California courts give priority to a bona fide purchaser over one claiming equitable subrogation.[32] Likewise, in *National Bank of Alaska v. Erickson* (*In re Seaway Express Corp.*), we held that "[w]hen a creditor claims an inchoate equitable interest in real property owned by the debtor at the commencement of the case, which interest is not evidenced by a recorded instrument and not yet granted by a state court, the trustee as bona fide purchaser prevails."[33]

CONCLUSION

The judgement of the Bankruptcy Appellate Panel is **AFFIRMED.**

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[32] *See, e.g.; J.G. Boswell Co. v. W.D. Felder & Co.*, 230 P.2d 386, 389-90 (Cal. Ct. App. 1951).

[33] 912 F.2d 1125, 1128-29 (9th Cir. 1990).

ORDERED PUBLISHED

UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE NINTH CIRCUIT

In re: JILL C. DEUEL, Debtor.	BAP Nos. SC-06-1132-MoSnK SC-06-1063-MoSnk (Consolidated)
HAROLD S. TAXEL, Chapter 7 Trustee, Appellant, v. CHASE MANHATTAN BANK, USA, N.A.; JILL C. DEUEL; WILL T. DEUEL; and LAKE VIEW CARLTON HILLS HOME-OWNERS ASSOCIATION, Appellees.	Bk. No. 04-02787 Adv. No. 06-90460 OPINION

Argued and Submitted on September 22, 2006
at Pasadena, California

Filed – December 28, 2006

Appeal from the United States Bankruptcy Court
for the Southern District of California

Honorable John J. Hargrove,
Bankruptcy Judge, Presiding.

Before: MONTALI, SNYDER,[1] and KLEIN, Bankruptcy Judges.

MONTALI, Bankruptcy Judge:

One of the most powerful weapons in a bankruptcy trustee's arsenal is the "strong arm" power of Section 544(a)(3)[2] to recover real property, subject to the same limitations that a bona fide purchaser would have when acquiring that property from the debtor outside of bankruptcy. Trustees for decades have defeated unperfected liens and unrecorded transfers, all to the benefit of unsecured creditors in bankruptcy.

The bankruptcy court rejected a trustee's attempt to exercise that power, relying on a Ninth Circuit decision holding that a petitioning creditor's unrecorded lien that is described in an involuntary bankruptcy petition operates as constructive notice sufficient to defeat the trustee. *In re Professional Investment Properties of America,* 955 F.2d 623 (9th Cir. 1992) ("*Professional Investment*"). But the court

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[1] Hon. Paul B. Snyder, Bankruptcy Judge for the Western District of Washington, sitting by designation.

[2] Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036, as enacted and promulgated prior to the effective date of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119 Stat. 23, because the case from which this appeal arises was filed before its effective date (generally October 17, 2005).

of appeals carefully limited its decision to the effect of the petition in the involuntary case, as distinguished from the schedules. *Id.* at 628 n. 3, *citing with approval, In re Gurs,* 27 B.R. 163, 165 (9th Cir. BAP 1983)[3].

Today we confirm that the trustee still has that powerful weapon, concluding that information contained in schedules and the statement of financial affairs filed in a voluntary bankruptcy case is not subject to the *Professional Investment* rule, and therefore is insufficient to defeat the trustee's power, regardless of notice. Thus we reject the bankruptcy court's contrary holding, which could operate to eviscerate a well-established avoiding power.

We also reject the bankruptcy court's alternative use of equitable subrogation to rescue a creditor that voluntarily released its previous lien on the debtor's property but neglected to record its new lien. Equitable subrogation would unduly prejudice the debtor's other creditors and the bankruptcy estate

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[3] Responding to the trustee's argument that information received after the filing of the involuntary petition could not affect his status, the court responded (in footnote 3):

> This is true. *In re Gurs,* 27 B.R. 163 (9th Cir. BAP 1983) defined a § 544(a)(3) hypothetical bona fide purchaser as one who is without actual knowledge "at the instant the petition is filed," and purchases property from the debtor for value and in good faith. Consequently, we will only discuss the ramifications of the petition itself.

and cannot override the trustee's statutory strong arm power.

Accordingly, we REVERSE.

I. FACTS

There are no material facts in dispute. In 1999 debtor Jill C. Deuel ("Debtor") and her former spouse Will T. Deuel (collectively, the "Deuels") purchased a residence in Santee, California (the "Property"). In 2001 they refinanced the Property with a $122,400.00 loan secured by a recorded deed of trust that was assigned to an affiliate of Chase Manhattan Bank USA, N.A. ("Chase") (the "Prior Deed of Trust"). On September 4, 2002, the Deuels refinanced this debt with a new $136,000.00 loan from Chase secured by a new deed of trust against the Property which by mistake was not recorded (the "Unrecorded Deed of Trust"). The Deuels used $121,170.79 of the new loan to pay off the balance of the 2001 loan. The Prior Deed of Trust was reconveyed by an instrument recorded on September 26, 2002.

Debtor filed her voluntary Chapter 7 bankruptcy petition that commenced this case on March 26, 2004 (the "Petition Date"). Harold S. Taxel was appointed as Chapter 7 trustee ("Trustee").

With her bankruptcy petition Debtor filed her bankruptcy schedules and statement of financial affairs ("SFA") which mentioned Chase's claim and alleged lien in several places. In Schedule A (Real

Property), she listed a "secured claim" of $134,740.00 against the Property. In Schedule D (Creditors Holding Secured Claims), she listed a claim held by Chase with a balance of $134,165.00, and stated: "Incurred: 2002, Lien: deed of trust, Security: [the Property]." In SFA item 3, she listed prepetition payments of $1000 per month to Chase. Attached to her SFA is a copy of her 2003 mortgage interest statement from Chase.

On October 26, 2004, Chase filed in the bankruptcy court a Complaint to Quiet Title to Deed of Trust Against Real Property, naming as defendants the Deuels, Trustee, and Lake View Carlton Hills Homeowners Association (the "HOA"). Trustee filed a motion to dismiss the complaint and in the alternative for summary judgment. The Deuels filed joinders. Chase filed an opposition and a cross-motion for summary judgment.

On January 5, 2005, the bankruptcy court held a hearing on these various motions and stated:

> . . . the schedules filed with the petition . . . provide constructive notice to the trustee as a bona fide purchaser of real property, that there was a secured claim out there. . . .
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> So it appears that, under the law of the Ninth Circuit – and I guess most specifically the circuit case is *[In re] Professional Investment Properties of America* [955 F.2d 623 (9th Cir. 1992)] – that the trustee in this case was on constructive notice that this security interest existed; and therefore under

> the law of the circuit, he is unable to set aside the lien, so to speak, or take priority over the bank under Section 544(a)(3).

Transcript Jan. 5, 2005, pp. 3:22-4:15.

The bankruptcy court also ruled in favor of Chase on grounds of equitable subrogation, Chase's alternative basis for relief. Chase argued that it was equitably subrogated to the (released) lien created by the Prior Deed of Trust. The bankruptcy court stated that all the elements of equitable subrogation appeared to be satisfied. Among other things:

> [T]here is case law out there . . . I think it was a case out of Hawaii that was cited by the [T]rustee [*In re Christie-Pequignot,* 2003 WL 22945921 (Bankr. D. Hi. October 24, 2003), *aff'd* BAP No. HI-03-1563-KMoB (9th Cir. BAP August 11, 2004)], showing that even if there is neglect, as long as there is no injustice to the [T]rustee or the other creditors – in other words, they're *not worse off* – then the equitable subrogation would apply.
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> . . . .
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> As the bank points out, under equitable subrogation the [T]rustee and the creditors would be *better off* to the tune, I think, of about $15,000, because the bank would only step into the shoes, so as to speak, of the original Chase loan, and as I recall, that was about $15,000 less than the loan which is the

> subject of this adversary proceeding. I guess there were some additional charges.
>
> . . . So if the doctrine of equitable subrogation applies, Chase is only subrogated to the amount of 122,400 and not the new amount of a hundred and thirty-six. So there clearly is *benefit* to the trustee and the creditors.[4] But it does appear that equitable subrogation does apply, and I would find – I would also grant the summary judgment in that regard for the bank.

Transcript Jan. 5, 2005, pp. 9:25-11:1 (emphasis added).

The bankruptcy court entered an order denying defendants' motions and granting Chase's cross-motion for summary judgment and thereafter issued a judgment in favor of Chase. Both the order and the judgment state that the defendants "have no right, title, interest or lien in or to the Property senior to the lien/security interest of [Chase] under the [Unrecorded] [D]eed of [T]rust."

Trustee filed timely notices of appeal from both the order (SC-06-1063) and the judgment

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[4] We read the bankruptcy court's comments about Trustee and creditors receiving a "benefit" and not being "worse off" to mean that it believed the bankruptcy estate was better off with Chase having a lien of $122,400 instead of $134,165. This appears to assume that Chase would otherwise be entitled to a lien of $134,165, which we reject below. Without any Chase lien, the estate is obviously "better off."

(SC-06-1132) and on his application we consolidated the two appeals. The notices of appeal were served on both of the Deuels and the HOA and name them as parties, but they have not participated in this appeal.

II. ISSUES

A. Is Trustee's status as a hypothetical bona fide purchaser under Section 544(a)(3) defeated by constructive or inquiry notice of Chase's Unrecorded Deed of Trust from Debtor's bankruptcy schedules and SFA?

B. Does the doctrine of equitable subrogation apply?

III. JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. § 157(b)(2)(K). We have jurisdiction under 28 U.S.C. § 158(c).

IV. STANDARDS OF REVIEW

We review de novo the bankruptcy court's rulings on the cross-motions for summary judgment and the motion to dismiss. *In re Garske,* 287 B.R. 537, 541 (9th Cir. BAP 2002) (summary judgment); *In re Laizure,* 349 B.R. 604, 606 (9th Cir. BAP 2006) (motion to dismiss complaint).

Although there is usually a factual question whether a purchaser has inquiry or constructive

notice (*Professional Investment,* 955 F.2d at 626) we believe that the bankruptcy court properly treated as a legal question whether a debtor's bankruptcy schedules impart constructive or inquiry notice. *Cf. In re Kim,* 161 B.R. 831, 836-37 (9th Cir. BAP 1993) (whether legally defective abstract of judgment gave constructive or inquiry notice was not a factual issue precluding summary judgment).

In the circumstances of this case, whether to apply the doctrine of equitable subrogation may also be an issue of law that we review de novo. *See Mort v. U.S.,* 86 F.3d 890, 893 (9th Cir. 1996) (deciding equitable subrogation issue, which district court had declined to decide, when "facts are undisputed and further factfinding is unnecessary"). We do not decide the proper standard of review because we would reach the same result on the equitable subrogation issue were we to review it for abuse of discretion. *See U.S. v. Avila,* 88 F.3d 229, 239 n. 12 (3d Cir. 1996) (assuming without deciding that application of equitable subrogation doctrine is reviewed for abuse of discretion). *See also Dieden v. Schmidt,* 128 Cal.Rptr.2d 365, 372 (2002) (stating, in a case involving equitable subrogation, "Summary judgment motions usually raise matters of law, but not when the trial court grants or denies such a motion on the basis of equitable determinations. The matter then becomes one of discretion, which this court reviews under the abuse of discretion standard.") (citation omitted).

V. DISCUSSION

A. Trustee's strong arm power arises "as of the commencement of the case," before there can be any constructive notice from Debtor's bankruptcy schedules

Chase makes no arguments against Trustee's strong arm power other than its reliance on *Professional Investment* and on equitable subrogation. The single question presented in this section of our discussion, therefore, is whether *Professional Investment* compels us to affirm.

Professional Investment acknowledges both the power of and limitations on the trustee's strong arm power. On the one hand, the trustee's status as a hypothetical bona fide purchaser is "without regard to" any actual knowledge of the trustee or of any creditor. 11 U.S.C. § 544(a)(3). On the other hand, the trustee only obtains those rights that a hypothetical purchaser without actual knowledge could have obtained under applicable law at the time the bankruptcy is commenced. *Professional Investment,* 955 F.2d at 627 (following *McCannon v. Marston,* 679 F.2d 13, 17 (3d Cir. 1982)); *In re Weisman,* 5 F.3d 417, 420-21 (9th Cir. 1993). Thus "[a] trustee does not become a hypothetical bona fide purchaser if she [or he] has been put on constructive or inquiry notice." *Professional Investment,* 955 F.2d at 627. *See also* 5 A. Resnick & H. Sommer, *Collier on Bankruptcy* ¶¶ 544.03, 544.08, pp. 544-9 *et seq* ("*Collier*") (trustee

deemed to have conducted title search and is subject to constructive or inquiry notice).[5]

In this case the timing of any constructive or inquiry notice is critical. The bankruptcy court held that Trustee had constructive notice of Chase's Unrecorded Deed of Trust from Debtor's bankruptcy schedules. We hold that whatever the Trustee learned from the schedules and SFA came too late and is irrelevant.

Section 544(a)(3) provides:

> (a) The trustee shall have, *as of the commencement of the case,* and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by –
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> * * *
>
> (3) A bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer *at the time of the commencement*

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[5] This discussion will refer to constructive or inquiry notice interchangeably. No party has suggested that there is any difference for purposes of this appeal.

> *of the case,* whether or not such a purchaser exists.

11 U.S.C. § 544(a)(3) (emphasis added).

A case is "commenced" by the filing of a petition. 11 U.S.C. §§ 301(a), 302(a), 303(b); Fed. R. Bankr. P. 1002(a). Thus the bankruptcy trustee has the status of a bona fide purchaser "at the instant the petition is filed." *Professional Investment,* 955 F.2d at 628 n. 3 (quoting *In re Gurs,* 27 B.R. 163, 165 (9th Cir. BAP 1983)). As the Ninth Circuit recognized in *Professional Investment,* "any information or notice which [the trustee] attained *after* that period [i.e., after the filing of the petition] did not bear on his status as a bona fide purchaser at the time of filing." *Professional Investment,* 955 F.2d at 628 and n. 3 (emphasis added).[6]

The bankruptcy schedules, SFA, and other required documents cannot be filed until there is a case in which to file them. As the applicable rules

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[6] The Ninth Circuit was applying Washington state law and this case involves California law but no party has cited any authority that this makes any difference or that notice *after* the filing of the petition would be sufficient to defeat Trustee's status as a bona fide purchaser in this case. *See Professional Investment,* 955 F.2d at 627 (bona fide purchaser must be without notice "*prior* to his acquisition of title") (emphasis added, citation omitted); Wash. Rev. Code § 65.08.070 (race notice statute); *In re Harvey,* 222 B.R. 888, 893 (9th Cir. BAP 1998) (applying California law); Cal. Civ. Code §§ 19 (constructive notice generally), 1213 (constructive notice re real property), *and* 1214 (race notice statute).

state, they must be filed "[i]n" a case. Fed. R. Bankr. P. 1007(a)-(c). *See In re Castro,* 158 B.R. 180, 183 (Bankr. C.D. Cal. 1993) ("The filing of a voluntary petition, not the schedules, commences the case."). *See also Harvey,* 222 B.R. at 895 nn. 11-12 (noting trustee's argument that bankruptcy schedules "are deemed filed *after* the filing of the petition that commences a bankruptcy case," but not deciding issue because other argument was dispositive) (emphasis in original).

In some cases (including this one) the bankruptcy schedules and other documents are presented for filing with the petition. That does not make them the same document, as evidenced by the separate Official Forms for each of them. *Compare* Official Forms 1 (voluntary petition) *and* 5 (involuntary petition) *with, e.g.,* Official Forms 6, 6A through 6J, and 7 (bankruptcy schedules and SFA). *See also Castro,* 158 B.R. at 183 ("[T]he petition and the schedules are separate documents."). Indeed, the Federal Rules of Bankruptcy Procedure specifically provide that most required documents can be filed up to 15 days after the petition. *See* Fed. R. Bankr. P. 1007(b) and (c).

For these reasons we hold that the bankruptcy schedules, SFA, and other required documents can only be filed after the petition, even if all these documents are physically presented to the clerk for filing together or if, as in this case, they are electronically combined into a single electronic file and transmitted onto the bankruptcy court's docket as such. All the pages of the documents might reach

the court at essentially the same instant, but conceptually the case must be commenced before the bankruptcy schedules, SFA, and other required documents can be filed in that case. Therefore, by definition, these documents cannot provide constructive notice "as of the commencement of the case." Any constructive or inquiry notice from Debtor's bankruptcy schedules and SFA came too late to defeat Trustee's strong arm power under Section 544(a)(3).

Nothing in *Professional Investment* holds otherwise. The Ninth Circuit stated, "This case turns on whether the *petition itself* put the trustee on sufficient inquiry or constructive notice of [the creditors'] prior security interest" and "we will only discuss the ramifications of the *petition itself.*" *Professional Investment,* 955 F.2d at 627 and 628 n.3 (emphasis added). In that case the petition itself did give notice: it was an involuntary petition and in the space provided for describing his claim one of the petitioners stated that his claims were "supposedly secured by assignments of Deeds of Trust . . . in the aggregate amount of approximately $137,500." *Id.* at 628 (quoting involuntary petition). In this case the petition is voluntary and there is not even a space on the form to give any notice of Chase's Unrecorded Deed of Trust. *See* Official Form 1 (voluntary petition). Trustee had no constructive or inquiry notice of Chase's purported lien from the voluntary petition. Accordingly, *Professional Investment* does not compel us to defeat Trustee's strong arm power. *See In re Thomas,* 147 B.R. 526, 531 n. 8 (9th Cir.

BAP 1992) ("In this case, unlike *Professional Investment Properties,* the petition made no mention of [the alleged constructive trust interest] in the property"), *aff'd,* 32 F.3d 572 (9th Cir. 1994) (table).[7]

Our holding is reinforced by the fact that Chase's reading of *Professional Investment* could lead to arbitrary results or abuse. If a debtor's bankruptcy schedules happen to be filed after the trustee is appointed – as often occurs in voluntary Chapter 7 cases because of the 15 day grace period for filing bankruptcy schedules in Fed. R. Bankr. P. 1007(c) – then presumably there is no constructive notice. *See*

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[7] Trustee argues that *Professional Investment* is contrary to the plain meaning of the statute. It is true that much of the Ninth Circuit's discussion focused on the time at which the trustee in that case was appointed, and that appears to be irrelevant under the statute which focuses on the time of "commencement of the case." 11 U.S.C. § 544. Perhaps the court did not focus on the fact that a hypothetical bona fide purchaser is just that – hypothetical – so the time of his actual appointment is irrelevant. *See Professional Investment,* 955 F.2d at 628 ("A trustee *who has not yet been appointed* can hardly argue that he has been prejudiced by being charged with notice by the petition") *and* 629 ("the trustee had a duty to inquire as to the nature of the [creditors'] claim *once he was appointed*") (emphasis added). *See also In re Wohlfeil,* 322 B.R. 302, 305-06 (Bankr. E.D. Mich. 2005) (criticizing *Professional Investment* as contrary to plain meaning of statute). We do not ignore binding precedent nor do we speculate further. We simply construe *Professional Investment* to be limited in its application to an involuntary petition wherein the petitioning creditor asserts its lien. We express no opinion as to the outcome in any future case wherein a voluntary petitioner departs from Official Form 1 and inserts information about a creditor.

Castro, 158 B.R. 180 (no constructive notice when trustee was appointed before schedules were filed). Likewise, if the bankruptcy schedules happen not to describe the unperfected claim adequately then there is no constructive notice. *See Harvey,* 222 B.R. at 895 (vague and inconsistent bankruptcy schedules "did not necessarily imply" ownership interest and therefore did not impart constructive notice). A debtor might even take advantage of the situation to favor or disfavor one creditor over others by adjusting the content of the bankruptcy schedules or the time when they are filed.

In sum, Debtor's bankruptcy schedules and SFA have no bearing on Trustee's strong arm power. They were filed after "the commencement of the case" so any constructive or inquiry notice of Chase's Unrecorded Deed of Trust came too late to defeat Trustee's statutory power as a hypothetical bona fide purchaser under Section 544(a)(3).

B. Equitable subrogation

The bankruptcy court held in the alternative that Chase could defeat Trustee's strong arm power under Section 544(a)(3) using the doctrine of equitable subrogation, up to the dollar amount of the lien under its released Prior Deed of Trust. The bankruptcy court held that Trustee and Debtor's creditors would not be "worse off" and there was no "injustice" from applying the doctrine. Again, we disagree.

Subrogation is a derivative right whereby one party is substituted in the place of another with reference to a lawful claim, demand, or right. *In re Hamada,* 291 F.3d 645, 649 (9th Cir. 2002). Equitable subrogation is a legal fiction and because it is a creature of equity it "is enforced solely for the purpose of accomplishing the ends of substantial justice." *Hamada,* 291 F.3d at 649 (citation omitted). The doctrine is governed by state law and one of the requirements of California law is that its application must "not work an injustice to the rights of others." *Golden Eagle Ins. Co. v. First Nationwide Fin. Corp.,* 31 Cal.Rptr.2d 815, 821 (1994); *Hamada,* 291 F.3d at 651 (same); M. Lilly, *Subrogation of Mortgages in California: a Comparison with the Restatement and Proposals for Change,* 48 UCLA L. Rev. 1633, 1660-61 at n. 120 and accompanying text (2001).

Equitable subrogation "allows a person who pays off an encumbrance to assume the same priority position as the holder of the previous encumbrance." *Mort,* 86 F.3d at 893. Even a canceled lien can be revived, but not if "the superior or equal equities of others would be prejudiced thereby." *Lawyers Title Ins. Corp. v. Feldsher,* 49 Cal.Rptr.2d 542, 546 (2d Dist. 1996) (citation and italics omitted). For example, the holder of a junior lien or interest is generally put in no worse situation if a third party who pays off the senior debt is equitably subrogated to the senior lien's priority. The junior lien or interest holder did not rely on the absence of the senior lien when it first extended credit or transferred value, and

would receive a windfall if the doctrine were not applied. *Mort,* 86 F.3d at 895.

This case is different. Trustee as a hypothetical bona fide purchaser is deemed to have given value for the Property without any knowledge of Chase's Unrecorded Deed of Trust and in reliance on the real estate records. *Gurs,* 27 B.R. at 165; 5 *Collier* ¶ 544.08, text accompanying n. 5, p. 544-16.2. As established in the previous section of our discussion Trustee had no constructive or inquiry notice of the Unrecorded Deed of Trust. Moreover, Chase had recorded a reconveyance of its Prior Deed of Trust and Trustee is deemed to have relied on that reconveyance. *See First Fidelity Thrift & Loan v. Alliance Bank,* 71 Cal.Rptr.2d 295 (1998) (subsequent mortgagee could rely on mistakenly recorded release).

California courts have held that the equities favor a bona fide purchaser over one asserting equitable subrogation. *See J.G. Boswell Co. v. W.D. Felder & Co.,* 230 P.2d 386, 389 (1951) (rejecting application of equitable subrogation as against bona fide purchaser); 58 *Cal. Jur. 3d, Subrogation* § 7 (2006), text accompanying nn. 10-13 ("subrogation will not be allowed where it would work an injustice to the rights of others and does not lie against an innocent person, as where it would jeopardize or defeat intervening rights, including those of *bona fide purchasers without notice*") (emphasis added).

The same result has been reached under the laws of other states. *See In re Zaptocky,* 250 F.3d 1020,

1028 (6th Cir. 2001) (under Ohio law, "the doctrine of equitable subrogation does not apply against a bona fide purchaser without knowledge"); *In re Bridge,* 18 F.3d 195, 204 (3d Cir. 1994) (trustee prevailed over creditor who was attempting to rely on its own previously released lien under equitable subrogation doctrine, applying New Jersey law).

We can conceive of circumstances in which the equities might favor application of the doctrine of equitable subrogation, but Chase has alleged no such circumstances. *See In re Reasonover,* 236 B.R. 219, 225-233 (Bankr. E.D. Va. 1999) (under Virginia law, when deed of trust had not yet been released as of petition date, trustee as bona fide purchaser took property subject to mortgage company's equitable subrogation claim), *remand after appeal,* 238 F.3d 414 (4th Cir. 2000) (table), *on remand,* 2001 WL 1168181 (Bankr. E.D.Va. 2001).

Trustee's status as a bona fide purchaser is not simply a legal technicality. It serves "one of the strongest policies behind the bankruptcy laws" – the policy of ratable distribution among all creditors. *In re Seaway Exp. Corp.,* 912 F.2d 1125, 1129 (9th Cir. 1990) (citation omitted) (avoiding creditor's inchoate equitable interest in real property when creditor had taken no steps to provide actual or constructive notice to subsequent bona fide purchasers). As stated in *Christie-Pequignot,* 2003 WL 22945921 at *5, a creditor holding a valid and perfected lien is entitled to preferential treatment but granting such treatment to an unperfected lien "would come at the

expense of other creditors and would be unjust to the other creditors." *See also Hamada,* 291 F.3d at 653 (rejecting equitable subrogation as applied to non-dischargeability judgment because creditor seeking subrogation made "no claim that [debtor] committed fraud against [creditor] that would entitle it to preferential treatment over other creditors to whom [debtor] owes money").

It would be inequitable to apply the legal fiction that Chase had never released its Prior Deed of Trust, thereby giving it nearly the full value of the Property and depriving Debtor's other creditors of a pro rata share of that value. Congress has determined as much by giving Trustee the status of a bona fide purchaser under Section 544(a)(3). Chase cannot defeat Trustee's statutory strong arm power based on equitable subrogation.[*]

VI. CONCLUSION

Section 544(a)(3) grants the bankruptcy trustee for the benefit of all creditors the rights of a bona fide purchaser of the real property "as of the commencement of the case." A debtor's bankruptcy schedules and other required documents cannot be filed until there is a case in which to file them, so by definition they cannot impart any constructive or inquiry notice

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[*] We do not address the other elements of equitable subrogation because Trustee has not argued that those elements are unsatisfied.

until after commencement of the case. Nothing in Debtor's bankruptcy schedules or SFA has any bearing on Trustee's statutory strong arm power to avoid Chase's Unrecorded Deed of Trust.

Nor is Trustee's statutory strong arm power defeated by the doctrine of equitable subrogation. That doctrine is only applied when it will not work an injustice to the rights of others, and if Chase received the entire value of the Property based on its released Prior Deed of Trust rather than sharing pro rata with other creditors that would work an injustice.

The judgment in favor of Chase is REVERSED and the case is REMANDED with directions to grant Trustee's motion for summary judgment and enter a judgment in favor of Trustee.

James C. Mitchell (CBA # 87151)
Daniel M. Gilleon (CBA # 195200)
Mitchell & Gilleon
530 B Street, Suite 2400
San Diego, CA 92101
Tel: 619.702.8623
Fax: 619.702.6337

Attorneys for Plaintiff Chase Manhattan Bank, USA, N.A.

UNITED STATES BANKRUPTCY COURT

SOUTHERN DISTRICT OF CALIFORNIA

IN RE: JILL C. DEUEL, Debtor, NO. 04-02787-JH-7	**ADV. NO. 04-90460-JH7** **JUDGMENT ON PLAINTIFF'S CROSS-MOTION FOR SUMMARY JUDGMENT** (Filed Mar. 10, 2006)
CHASE MANHATTAN BANK, USA, N.A., a nationally chartered bank, Plaintiff, vs. JILL C. DEUEL; WILL T. DEUEL, HAROLD S. TAXEL, Chapter 7 Trustee and LAKE VIEW CARLTON HILLS HOMEOWNERS ASSOCIATION, Defendants.	

Based upon the Order Granting the Cross-Motion for Summary Judgment By Plaintiff Chase Manhattan Bank, USA, N.A., entered on January 30, 2006, and for good cause;

The Court orders as follows:

1. The deed of trust dated September 4, 2002 between plaintiff Chase Manhattan Bank, USA, N.A., as beneficiary, and defendants Jill C. Deuel and Will T. Deuel, as trustors, a true and correct copy of which is attached hereto, that secures a $136,000 promissory note between Chase, as holder, and the Deuels, as maker, is confirmed as a lien/security interest against the real property at 9236 Mast Blvd., Unit 17, Santee, California 92071, legally described below (the "Property") effective September 4, 2002;

Parcel 1:

An undivided 1/47th interest in and to Lot 3 of County of San Diego Tract 3766, in the City of Santee, County of San Diego, State of California according to Map thereof No. 9517, filed in the Office of the County Recorder of San Diego County, January 9, 1980.

Excepting therefrom the following:

(A) Units 1 through 47 inclusive, and Garages 13 through 47, inclusive, as shown upon the Lakeview Carlton Hills Condominium Plan, recorded May 29, 1981 as File No. 81-168346 of Official Records of San Diego County.

Parcel 2:

Unit 17 and Garage 17 as shown upon the Condominium Plan above referred to.

2. Defendants Jill C. Deuel, Will T. Deuel, Harold S. Taxel, Chapter 7 Trustee and Lakeview Carlton Hills Homeowners Association have no right, title, interest or lien in or to the Property senior to the lien/security interest of plaintiff under the September 4, 2002 deed of trust; and

3. Plaintiff is awarded its cost of suit and, if allowed by law, reasonable attorneys' fees.

Dated: 3-10-06 /s/ John J. Hargrove
John J. Hargrove, Judge,
United States Bankruptcy Court

Certification Under F.R.B.P., Rule 9011 that the relief in this order is the relief granted by the Court.

Mitchell and Gilleon

By: /s/ James C. Mitchell
James C. Mitchell,
Attorneys for Plaintiff
Chase Manhattan Bank, USA, N.A

James C. Mitchell (CBA # 87151)
Daniel M. Gilleon (CBA # 195200)
Mitchell & Gilleon
530 B Street, Suite 2400
San Diego, CA 92101
Tel: 619.702.8623
Fax: 619.702.6337

Attorneys for Plaintiff Chase Manhattan Bank, USA, N.A.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

IN RE: JILL C. DEUEL, Debtor, NO. 04-02787-JH-7	**ADV. NO. 04-90460-JH7** **ORDER DENYING DEFENDANTS' MOTION TO DISMISS/ SUMMARY JUDGMENT AND GRANTING PLAINTIFF'S CROSS-MOTION FOR SUMMARY JUDGMENT** (Filed Jan. 30, 2006)
CHASE MANHATTAN BANK, USA, N.A., a nationally chartered bank, Plaintiff, vs. JILL C. DEUEL; WILL T. DEUEL, HAROLD S. TAXEL, Chapter 7 Trustee and LAKE VIEW CARLTON HILLS HOMEOWNERS ASSOCIATION, Defendants.	

The motion to dismiss/summary judgment motion of defendant Harold S. Taxel, Chapter 7 Trustee, which motion was joined in by defendants Will T. Deuel and Jill C. Deuel and the cross-motion for summary judgment by plaintiff Chase Manhattan Bank, USA, N.A., was heard on January 5, 2005 at 10:00 a.m. in Department 3 of this Court, Judge John J. Hargrove, presiding. Michael Y. MacKinnon, Pyle Sims Duncan & Stevenson, appeared on behalf of defendant Harold S. Taxel, Chapter 7 Trustee, James C. Mitchell, Mitchell & Gilleon appeared on behalf of plaintiff Chase Manhattan Bank USA NA; there were no appearances by defendants Jill C. Deuel, Will T. Deuel or Lakeview Carlton Hills Homeowners Association. Based on the moving, opposing and reply pleadings on the motions, the arguments of counsel, the reasons stated by the Court at the hearing and for good cause;

The Court orders as follows:

1. Defendants' motion to dismiss/summary judgment motion is denied;

2. Plaintiff's cross motion for summary judgment is granted;

3. The deed of trust dated September 4, 2002 between plaintiff Chase Manhattan Bank, USA, N.A., as beneficiary, and defendants Jill C. Deuel and Will T. Deuel, as trustors, that secures a $136,000 promissory note between Chase, as holder, and the Deuels, as maker, is confirmed as a lien/security interest against the real property at 9236 Mast Blvd., Unit 17,

Santee, California 92071, legally described below (the "Property") effective September 4, 2004;

Parcel 1:

An undivided 1/47th interest in and to Lot 3 of County of San Diego Tract 3766, in the City of Santee, County of San Diego, State of California according to Map thereof No. 9517, filed in the Office of the County Recorder of San Diego County, January 9, 1980.

Excepting therefrom the following:

(A) Units 1 through 47 inclusive, and Garages 13 through 47, inclusive, as shown upon the Lakeview Carlton Hills Condominium Plan, recorded May 29, 1981 as File No. 81-168346 of Official Records of San Diego County.

Parcel 2:

Unit 17 and Garage 17 as shown upon the Condominium Plan above referred to.

4. Defendants Jill C. Deuel, Will T. Deuel, Harold S. Taxel, Chapter 7 Trustee and Lakeview Carlton Hills Homeowners Association have no right, title, interest or lien in or to the property senior to the lien/security interest of plaintiff under the September 4, 2002 deed of trust; and

5. The disposition of these motions and of this complaint is without prejudice to the Trustee's rights to file a complaint to enforce his avoidance powers

pursuant to sections 547, 549 and 550 of the Bankruptcy Code (11 U.S.C. §§ 547, 549 and 550.)

6. Plaintiff is awarded its cost of suit and, if allowed by law, reasonable attorneys' fees.

Dated: JAN 30 2006 /s/ John J. Hargrove
John J. Hargrove, Judge,
United States Bankruptcy
Court

Certification Under F.R.B.P., Rule 9011
that the relief in this order is the relief
granted by the Court.

Mitchell and Gilleon

By: /s/ James C. Mitchell
James C. Mitchell,
Attorneys for Plaintiff
Chase Manhattan Bank,
USA, N.A.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA
JUDGE JOHN J. HARGROVE, PRESIDING

IN THE MATTER OF: CHASE MANHATTAN BANK, USA, N.A. v. JILL C. DEUEL	)	CASE NO. 04-02787-JH

1) TRUSTEE'S MOTION TO DISMISS COMPLAINT AND FOR SUMMARY JUDGMENT

2) JILL C. DEUEL AND WILL T. DEUEL'S JOINDER IN MOTION TO DISMISS

REPORTER'S TRANSCRIPT OF PROCEEDINGS

SAN DIEGO, CALIFORNIA

WEDNESDAY, JANUARY 5, 2005

U.S. COURTHOUSE
DEPARTMENT NO. 3
325 WEST F STREET
SAN DIEGO, CA 92101

FEDERAL COURT REPORTERS
BY PATRICIA A. CALLIHAN
325 WEST F STREET
SAN DIEGO, CA 92101
(760) 729-9019

APPEARANCES:

FOR THE TRUSTEE:

MICHAEL MACKINNON
PYLE, SIMS, DUNCAN & STEVENSON
401 B STREET, SUITE 1500
SAN DIEGO, CA 92101
(619) 699-5285

FOR THE PLAINTIFF:

JAMES MITCHELL
MITCHELL & GILLEON
2400 UNION BANK BLDG.
530 B STREET
SAN DIEGO, CA 92101
(619)702-8623

* * *

[12] again address that in the succeeding complaint.

THE COURT: Okay. All right. Well, again, let me just make a couple more recitals under a 12(b) motion to dismiss, which is, what started this hearing:

"Dismissal is warranted when the complaint fails to state a cognizable legal theory or fails to allege sufficient facts to support a cognizable legal theory."

Well, the facts are there. This is a quiet title action. The facts are all in the complaint. And the legal theory is that the bank wants the quiet title based on equitable subrogation and on the fact that the trustee was not a bona fide purchaser for value and had constructive notice of this lien – unrecorded

lien – unrecorded security interest – by virtue of the debtor's schedules.

As I indicated in my tentative findings, this is a cognizable legal action, and therefore the trustee's motion to deny the – or to dismiss the complaint would be denied. The bank brought a cross-motion for – or a motion for summary judgment, and the trustee also brought a cross-motion, so that's not at issue, the fact that cross summary judgment motion arose in the context of a response to the motion to dismiss.

Again, defense of a summary judgment motion requires more than a mere denial. The nonmoving party must. submit significant probative evidence in opposition. And [13] there really isn't any evidence in opposition. I can't see any disputed facts that – the trustee at one point argues that the motion is premature, because I guess he wanted to explore the idea of possible actual knowledge.

I'm looking at page 2 of the trustee's response – opposition, rather. It says the trustee had no personal knowledge or information regarding the existence of the trust deed. And again, as is pointed out in *Professional Investment Properties*, page 627 – it's actually in the footnote – and again in the *Harvey* case, the BAP case, 893: "Actual knowledge, personal knowledge is not relevant in these 544(a)(3) matters." And so I don't think that's a reason for denying the summary judgment motion. It's constructive. Constructive knowledge is the test.

As far as the jurisdiction the Court has, this is a core proceeding. Clearly it's core in 28 USC 157(b)(2)(A) and (K), probably (O). And as I indicated, once again, Section 544 creates the strong-arm powers of the trustee which close the trustee with the status of a bona fide purchaser of real property. What I'm doing is reading from the *Harvey* case, the BAP case, 222 BR 888, which came after the *Professional Investment* case, which would summarize the law.

And even though *Harvey* – the *Harvey* BAP panel [14] reversed the case – reversed the bankruptcy court because it found that the pleadings filed on the petition were vague – and I would agree with the BAP in that regard. They weren't crystal clear as to what was involved. And that matter was actually remanded for further hearing, unlike our case, which, once again, I've indicated the record is crystal clear. The schedules, as I recited earlier, are crystal clear that there was a lien indicating the amount.

And also I will note that the facts are undisputed that the actual deed was signed and notarized by the debtors and returned, I guess, to Chase and just got lost in the cracks, lost in somebody's drawer someplace and never got recorded.

But again, even though the trustee has the BFP status under Section 544(a), state law determines the – whether the trustee's status as a BFP will defeat the rights of the person against whom the trustee wishes to assert his powers.

And then we've got to look at California law, which we do. And California law has California Civil Code Section 19, which provides – which defines constructive notice and states that:

"Every person who has actual notice of circumstances sufficient to put a prudent man upon inquiry [15] as to a particular fact has constructive notice of the fact itself in all cases in which, by prosecuting such inquiry, he might have learned such a fact."

And again, that leads us into what facts might put the trustee – or give the trustee constructive notice, and I've just touched on those earlier, the facts in the schedule that the debtors indicated there was a secured claim in favor of Chase.

So for all these reasons it appears to me that the bank, I think, should – title should be quieted in as much as the deed of trust should be recognized vis-à-vis the trustee and the creditors of this estate as well as the debtors. They joined in the motion. They're not here to argue their case. They're just a joinder. So my ruling also affects the debtors and this homeowner's association. There's a joinder filed. I guess their claim, their lien would be subordinate to the bank's claim, but I haven't seen nor heard from them, but they join in.

Mr. Mitchell, the trustee's motion also applies to the debtors and the homeowner's association. Any questions?

MR. MITCHELL: No, your Honor. I'll prepare the order.

THE COURT: You need to prepare the summary judgment. All right. Thanks, Counsel. And happy new year

* * *

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(2)

No. 09-1334

Supreme Court, U.S.
FILED
JUN 2 - 2010
OFFICE OF THE CLERK

In The

Supreme Court of the United States

CHASE MANHATTAN BANK, USA, N.A.,

Petitioner,

vs.

HAROLD S. TAXEL, Chapter 7 Trustee,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

MICHAEL Y. MACKINNON*
KATHLEEN A. CASHMAN-KRAMER
PYLE SIMS DUNCAN & STEVENSON APC
401 "B" Street, Suite 1500
San Diego, CA 92101
Tel: 619-687-5200
Fax: 619-687-5210
Email: miguelm@psdslaw.com
Attorneys for Respondent
Harold S. Taxel, Chapter 7 Trustee

**Counsel of Record*

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

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RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

Respondent Harold S. Taxel, Chapter 7 Trustee ("Trustee") of the Chapter 7 estate of Jill C. Deuel respectfully submits this Brief in Opposition to the Petition for Writ of Certiorari ("Petition") filed by Petitioner Chase Manhattan Bank, USA, NA ("Chase" or "Petitioner").

INTRODUCTION

This case presents an issue of bankruptcy law involving 11 U.S.C. Section[1] 544(a)(3), a section which is neither novel nor ambiguous.[2] Petitioner has presented no "compelling reasons" to grant its Petition. *See* Sup. Ct. R. 10. More specifically, contrary to the Petitioner's argument, the Petitioner's first question presented does not involve an intra-circuit (or

[1] All references to "Section" are to the Bankruptcy Code, 11 United States Code, unless otherwise specified.

[2] Section 544(a)(3) provides: "The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by – . . . (3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists."

any other) conflict; and incorrectly classifies the decision of the Ninth Circuit Court of Appeals by assuming wrong facts. In addition, the Petitioner's second question assumes that the decision of the Ninth Circuit Court of Appeals was in conflict with applicable California state law. For the reasons set forth herein, that assumption is incorrect. As a result, Respondent urges this Court to deny the Petition.

RESPONDENT'S COUNTER-STATEMENT OF THE CASE

A. The Facts – Proceedings in the Bankruptcy Court.

As the Bankruptcy Appellate Panel for the Ninth Circuit ("BAP") noted in its decision, *In re Deuel*, reported at 361 B.R. 509 (9th Cir. BAP 2006), and as Petitioner agrees, "[t]here are no material facts in dispute." As a result, the following facts are reiterated from the BAP decision. In 1999 debtor Jill C. Deuel ("Debtor") and her former spouse Will T. Deuel (collectively, the "Deuels") purchased a residence in Santee, California (the "Property"). In 2001 they refinanced the Property with a $122,400.00 loan secured by a recorded deed of trust that was assigned to an affiliate of Chase Manhattan Bank USA, N.A. ("Chase") (the "Prior Deed of Trust"). On September 4, 2002, the Deuels refinanced this debt with a new $136,000.00 loan from Chase secured by a new deed of trust against the Property which by mistake was not recorded (the "Unrecorded Deed of

Trust"). The Deuels used $121,170.79 of the new loan to pay off the balance of the 2001 loan. The Prior Deed of Trust was reconveyed by an instrument recorded on September 26, 2002. *Id.* at 511-12.

The Debtor filed her voluntary Chapter 7 bankruptcy petition that commenced this case on March 26, 2004 (the "Petition Date"). Harold S. Taxel was appointed as Chapter 7 Trustee ("Trustee"). With her bankruptcy petition Debtor filed her bankruptcy schedules and statement of financial affairs ("SFA") which mentioned Chase's claim and alleged lien in several places. In Schedule A (Real Property), she listed a "secured claim" of $134,740.00 against the Property. In Schedule D (Creditors Holding Secured Claims), she listed a claim held by Chase with a balance of $134,165.00, and stated: "Incurred: 2002, Lien: deed of trust, Security: [the Property]." In SFA item 3, she listed prepetition payments of $1000 per month to Chase. Attached to her SFA is a copy of her 2003 mortgage interest statement from Chase. *Id.* at 512.

On October 26, 2004, Chase filed in the bankruptcy court a Complaint to Quiet Title to Deed of Trust Against Real Property, naming as defendants the Deuels, the Respondent/Trustee, and Lake View Carlton Hills Homeowners Association (the "HOA"). Trustee filed a motion to dismiss the complaint and in the alternative for summary judgment, in which the Deuels joined. Chase filed an opposition and a cross-motion for summary judgment. On January 5, 2005, the Bankruptcy Court granted judgment in favor of

Petitioner, basing its ruling on the following: " . . . the schedules filed with the petition . . . provide constructive notice to the trustee as a bona fide purchaser of real property, that there was a secured claim out there . . . " and then expanded the holding in *In re Professional Investment Properties of America*, 955 F.2d 623 (9th Cir. 1992) ("*Professional Investment*") to conclude that the Respondent was unable to set aside the lien and would thus not take priority over Respondent under Section 544(a)(3). *Id.* at 512-13.

The Bankruptcy Court also ruled in favor of Chase on grounds of equitable subrogation, Chase's alternative basis for relief. Chase argued that it was equitably subrogated to the (released) lien created by the Prior Deed of Trust. The bankruptcy court stated that all the elements of equitable subrogation appeared to be satisfied. The bankruptcy court entered an order denying defendants' motions and granting Chase's cross-motion for summary judgment and thereafter issued a judgment in favor of Chase. Both the order and the judgment state that the defendants [i.e. the Respondent/Trustee, the HOA, and the Deuels] "have no right, title, interest or lien in or to the Property senior to the lien/security interest of [Chase] under the [Unrecorded] [D]eed of [T]rust." *Id.* at 513. Respondent timely appealed to the BAP.

B. The Decision of the Ninth Circuit Bankruptcy Appellate Panel (*In re Deuel*, 361 B.R. 509 (9th Cir. BAP 2006)).

Upon appeal from the Bankruptcy Court's ruling in favor of Petitioner that the Respondent/Trustee could not set aside the security interest under the unrecorded deed of trust, the BAP overruled the Bankruptcy Court's decision and held that: (1) the Trustee did not have constructive or inquiry notice of the unrecorded deed of trust, and (2) the creditor was not equitably subrogated to the released lien. It then reversed and remanded the Bankruptcy Court's Order granting summary judgment to Petitioner.

In doing so, the BAP recognized that "[o]ne of the most powerful weapons in a bankruptcy trustee's arsenal is the 'strong arm' power of Section 544(a)(3) to recover real property, subject to the same limitations that a bona fide purchaser would have when acquiring that property from the debtor outside of bankruptcy. Trustees for decades have defeated unperfected liens and unrecorded transfers, all to the benefit of unsecured creditors in bankruptcy." 361 B.R. at 510.

The BAP also carefully considered the Bankruptcy Court's reliance on the *Professional Investment* decision. The BAP recognized that "the court of appeals (in *Professional Investment*) carefully limited its decision to the effect of the petition in the involuntary case, as distinguished from information in the schedules. *Id.* at 628 n. 3, citing with

approval, *In re Gurs*, 27 B.R. 163, 165 (9th Cir. BAP 1983)." *Id.* at 511. The BAP in *Gurs* stated that "a § 544(a)(3) hypothetical bona fide purchaser as one who is without actual knowledge "at the instant the petition is filed," and purchases property from the debtor for value and in good faith." *In re Gurs*, 27 B.R. at 165. As a result, the BAP concluded that the information contained in a debtor's schedules and the statement of financial affairs filed in a voluntary bankruptcy case is not subject to the "Professional Investment rule," and therefore, those documents were not sufficient to impart notice or to defeat the Trustee's power.

The BAP also found that equitable subrogation did not apply to defeat Trustee Taxel's status as a bona fide purchaser under Section 544(a)(3). 361 B.R. at 518.

Petitioner timely appealed the BAP's decision to the Ninth Circuit Court of Appeals.

C. The Ninth Circuit Decision: *Chase v. Taxel (In re Deuel)*, 594 F.3d 1073 (2010).

The Ninth Circuit Court of Appeals ("Ninth Circuit"), at 594 F.3d. 1073 (9th Cir. 2010), affirmed the BAP's decision in all respects.

REASONS FOR DENYING THE INSTANT PETITION

Petitioner urges this Court to grant certiorari for two reasons. First, it claims that the Ninth Circuit's analysis and decision somehow ignore and, indeed, change the application of the law due to the advent of electronic filing of documents. Pet., pp. 13-16. It contends, inter alia, that both the BAP and the Ninth Circuit "departed" (Pet., p. 13) from settled law. Petitioner contends, inter alia, that *Professional Investment* compels a finding that "like the trustee in Professional Investment, the bankruptcy petition and the schedules put [Respondent] on inquiry or constructive notice of the Chase deed of trust." Pet., p. 15. Second, Petitioner urges that the Ninth Circuit's decision somehow misapplies California state law regarding notice of facts affecting title to real property. Pet., pp. 20-27. Neither argument has merit. The Ninth Circuit's opinion does not stray from established precedents, including applicable California state law precepts and, for the following reasons, the Petition should be denied.

I. Petitioner Has Presented No "Compelling Reasons" To Grant Its Petition.

One of the factors that this Court considers in deciding whether to grant certiorari is whether the decision is "in conflict with the decision of another United States Court of Appeals on the same important matter." Sup. Ct. R. 10(a). Petitioner does not specifically assert this ground. Rather, Petitioner

argues that there are no Supreme Court decisions which construe Section 544(a)(3) and, because this section involves an "important question of federal law," this Court should grant certiorari. Petitioner's argument is simply that the BAP and Ninth Circuit erred in refusing to expand the holding in *Professional Investments* beyond its application in an involuntary case. Moreover, Petitioner cannot cite to any conflict between the courts of appeals. In fact, Respondent has not located any published decision by any circuit court, by any district court, or by any bankruptcy appellate panel holding that the schedules in a voluntary chapter 7 case imparted knowledge to a chapter 7 trustee, which knowledge would be sufficient to negate his bona fide purchaser status and disabling his use of Section 544(a)(3).

Petitioner also suggests, without support, that this Court's review is necessary to help enforce Congress's intent in enacting Section 544(a)(3). Pet., p. 27. There is no support for any of Petitioner's positions and, therefore, no "compelling reason" for the granting of the instant Petition. As a result, the Petition should be denied.

A. The Court of Appeals Correctly Ruled That Respondent Was Entitled to Exercise his Strong-Arm Powers Under Section 544(a)(3) as the Bankruptcy Trustee and Take a Senior Interest Ahead of the Unrecorded Lien of the Petitioner.

Contrary to what the Petitioner advances, *Professional Investments* does not limit a trustee's Section 544(a)(3) avoiding powers in a voluntary chapter 7 case. As both the BAP and Ninth Circuit correctly recognized, *Professional Investment* addressed an extremely limited factual situation, namely, the filing of an involuntary Chapter 7 petition by the very creditor who asserted a security interest in real property on the face of the involuntary petition. Quite different from a voluntary filing, an involuntary petition predates the entry of the order for relief under which the trustee is appointed. *Cf.* Sections 301(b) (voluntary cases) with 303(h) (involuntary cases). "Voluntary and involuntary petitions operate differently in many respects: one is filed by the debtor, the other by a creditor; one does not list claims, the other states what interest the creditor filing it has; the commencement of a voluntary case by a petition "constitutes an order" (the automatic stay), but an involuntary petition does not." 594 F.3d at 1078.

Petitioner misstates a major factor that served as one of the bases for the BAP and Ninth Circuit decision. Petitioner states in its Petition that "[t]he Court of Appeals for the Ninth Circuit held that a *debtor's* bankruptcy petition may give inquiry or

constructive notice to a bankruptcy trustee of an unrecorded interest in a debtor's real property, under the law of the state where the property is located, that is sufficient to defeat a trustee's status as a hypothetical bona fide purchaser under 11 U.S.C. § 544(a)(3)." Pet., p. 3. This statement is misleading because this is not what the Ninth Circuit in *Professional Investment* held, as it was not the *debtor's* petition that put the trustee on notice, it was the involuntary petition filed by the creditor.

Among the required disclosures in a voluntary Chapter 7 petition is a list of prior filings for relief under Title 11. While Petitioner continues to argue (as it did before the BAP and Ninth Circuit) that this disclosure (with which the Debtor complied) puts Respondent/Trustee on constructive notice of the information contained in a prior year's Chapter 13 petition, Petitioner does not provide any explanation why outdated information that did not correspond with the current official records of the San Diego County (California) Recorder's Office would put a Chapter 7 trustee on constructive notice of Chase's unrecorded deed of trust. Indeed, even Petitioner does not dispute that a careful review of the San Diego County Recorder's Office records would have revealed that Petitioner had no deed of trust of record on the petition date: "[t]he problem, that resulted in this lawsuit, is that the new $136,000 Chase deed of trust was, by mistake, never recorded." Pet., p. 5.

The BAP addressed the issue of the information contained in the schedule of assets and liabilities (the "Schedules"). Specifically, the BAP ruled that, "by

definition, these documents [the Schedules] cannot provide constructive notice 'as of the commencement of the case' because it is only the petition that commences the case." 361 B.R. at 514-15. The BAP's conclusion was based in part on the nature of the documents themselves:

> In some cases (including this one) the bankruptcy schedules and other documents are presented for filing with the petition. That does not make them the same document, as evidenced by the separate Official Forms for each of them. Compare Official Forms 1 (voluntary petition) and 5 (involuntary petition) with, e.g., Official Forms 6, 6A through 6J, and 7 (bankruptcy schedules and SFA). See also *Castro*, 158 B.R. at 183 ("[T]he petition and the schedules are separate documents."). Indeed, the Federal Rules of Bankruptcy Procedure specifically provide that most required documents can be filed up to 15 days after the petition. See Fed. R. Bankr.P. 1007(b) and (c).
>
> For these reasons we hold that the bankruptcy schedules, SFA, and other required documents can only be filed after the petition, even if all these documents are physically presented to the clerk for filing together or if, as in this case, they are electronically combined into a single electronic file and transmitted onto the bankruptcy court's docket as such. All the pages of the documents might reach the court at essentially the same instant, but conceptually the

> case must be commenced before the bankruptcy schedules, SFA, and other required documents can be filed in that case. Therefore, by definition, these documents cannot provide constructive notice "as of the commencement of the case." Any constructive or inquiry notice from Debtor's bankruptcy schedules and SFA came too late to defeat Trustee's strong arm power under Section 544(a)(3).

361 B.R. at 515.

One of the major flaws in Petitioner's argument – as it has been all along – was recognized by the Ninth Circuit in its decision:

> [Petitioner] correctly argues that a real person buying the property and checking the court records would know from the schedules Deuel filed simultaneously with her petition that it had a lien. But we are talking about a metaphysical and not a real person. The trustee who is treated as a bona fide purchaser for value without notice as of the commencement of the case does not yet exist at the commencement of the case. The schedules may be filed simultaneously or within 15 days after the petition is filed [citing Fed. R. Bankr.P. 1007(c)], and there is no reason to condition the trustee's strong arm power on whether they are filed earlier than they need to be.

594 F.3d at 1077.

Indeed, the BAP had analyzed the differences between the voluntary petition form used in this case and the involuntary form used in the *Professional Investment* case, and noted that the involuntary petition form itself – unlike the voluntary petition form used in this case – has a space provided for the filing creditor to describe his claim. Specifically, in *Professional Investment*, the petitioning creditor described his claims as "supposedly secured by assignments of Deeds of Trust" [*Professional Investment*, 955 F.2d at 628], and that the voluntary form used in this case does not have "a space on the form to give any notice of Chase's Unrecorded Deed of Trust." 361 B.R. at 514-15. In addition, the petition and schedules are on different official forms. Compare Official Form 1 (voluntary petition) with Official Form 5 (involuntary petition). 594 F.3d at 1077. Finally, Petitioner continues to ignore that the plain language of Section 544 states that the Trustee's strong arm power exists "without regard to any knowledge of the trustee." 11 U.S.C. § 544(a).

B. Even if the Ninth Circuit Ignored the *Professional Investment Properties* Case, This Case Would Not Be Worthy of Certiorari.

Petitioner's argument necessarily calls for a change in the current law without offering any support for this proposition. The law as applied by the BAP and the Ninth Circuit is that a case is "commenced" by the filing of a petition. Sections 301(a), 302(a), 303(b);

Fed. R. Bankr.P. 1002(a). "Thus the bankruptcy trustee has the status of a bona fide purchaser 'at the instant the petition is filed.' *Professional Investment*, 955 F.2d at 628 n. 3 (quoting *In re Gurs*, 27 B.R. 163, 165 (9th Cir.BAP1983))." 361 B.R. at 515. In addition, "any information or notice which [the trustee] attained after that period [i.e., after the filing of the petition] did not bear on his status as a bona fide purchaser at the time of filing." *Professional Investment*, 955 F.2d at 628 and n. 3. In addition,

> [t]he bankruptcy schedules, SFA, and other required documents cannot be filed until there is a case in which to file them. As the applicable rules state, they must be filed "[i]n" a case. Fed. R. Bankr.P. 1007(a)-(c). See *In re Castro*, 158 B.R. 180, 183 (Bankr. C.D. Cal. 1993) ("The filing of a voluntary petition, not the schedules, commences the case."). See also *Harvey*, 222 B.R. at 895 nn. 11-12 (noting trustee's argument that bankruptcy schedules "are deemed filed *after* the filing of the petition that commences a bankruptcy case," but not deciding issue because other argument was dispositive) (emphasis in original).

361 B.R. at 515.

Petitioner asserts, without authority, that the advent of the technology of "efiling" of documents should, somehow, supplant or replace existing law, and should dictate a change to that law. Petitioner specifically claims that "[t]he BAP and the Court of Appeals. . . .

ignored the realities of electronic transmission of documents, or efiling of pleadings or documents, and how this technology, in actuality, impacts the knowledge a trustee obtains the instant a bankruptcy petition is filed." Pet., p. 13. Petitioner further argues that "the Court of Appeals imposed a standard for determining the legal effect of the simultaneous electronic transmission and filing of documents that ignores the practical and actual effect of this technology and what really happened. It is undisputed that the filing of the bankruptcy petition and the debtor's schedules, as well as the creation and appointment of Taxel as the bankruptcy Trustee and hypothetical bona fide purchaser, all occurred at the same moment in time because of the simultaneous electronic filing of the two official court forms." Pet., p. 15-16.

The Bankruptcy Code (11 United States Code) and the Federal Rules of Bankruptcy Procedure contemplate that debtors may well file their schedules at the same time that they file their petitions in a voluntary case. *See* Section 521(a)(1)(B)(i); Fed. R. Bankr.P. 1007(c), "[i]n a voluntary case, the schedules and statements, other than the statement of intention, shall be filed with the petition, or within 15 days thereafter . . . " This procedure was in effect prior to the enactment of the Bankruptcy Code. *See, e.g.*, Rules 108(a), (b) of the Bankruptcy Rules to the Bankruptcy Act of 1898: "[t]he bankrupt shall file with the court schedules of all his debts and all his property and a statement of his affairs, prepared by him in the manner prescribed by official forms No. 6

and either No. 7 or No. 8, whichever is appropriate." Petitioner urges the Court to treat the advent of electronic filing as a reason to change established law and to effect a merger of the voluntary petition with the schedules. In the majority of voluntary Chapter 7 cases, the trustee is appointed after the schedules are on file. Petitioner would have the applicability of Section 544(a)(3) depend upon whether the debtor filed the schedules before or after the trustee was appointed. Such thinking is contrary to the fundamental bankruptcy policy by which assets are liquidated and distributed pro rata in accordance with the priorities established by Congress. Petitioner's position, if taken to its logical conclusion, would result in a judicial "repeal" of Section 544(a)(3).

Petitioner's argument notwithstanding, the Ninth Circuit indeed considered and rejected Petitioner's position below:

> In this case the petition and the schedules were filed simultaneously by means of electronic filing. Does that mean that the trustee took with notice of the lien disclosed in the schedules? If we were talking about real people walking over to the bankruptcy court and looking at the documents, the answer would be yes, but we are not. As is often the case in property law, we speak not of the physical but of the metaphysical. The statute says that a chapter 7 bankruptcy is "commenced by the filing with the bankruptcy court of a petition," so the petition and only the petition commences the case, regardless

> of what else happens at the same time. As the Bankruptcy Appellate Panel explained, the schedules "cannot be filed until there is a case in which to file them." The trustee has not even been appointed when the petition is filed, and could not possibly be a bona fide purchaser for value without notice upon the filing of the petition, but he is treated by the statute as though he were.

594 F.3d at 1076-77 (footnotes omitted). The Ninth Circuit went on to note that

> [t]he conclusion we reach is not based solely on literalism and metaphysics. It is practical. The Bankruptcy Appellate Panel correctly pointed out that if schedules could defeat the trustee's status as a bona fide purchaser for value without notice in a voluntary petition, a debtor could use simultaneous filing of petition and the schedules to favor one creditor over others. Sometimes creditors and debtors acting together before the bankruptcy have good reason to delay recording (footnote) and may have a continuing reason after filing to keep assets from other creditors. A fundamental purpose of bankruptcy is fair distribution pro rata within the classes of creditors determined by Congress of a debtor's inadequate assets. (footnote) That purpose could be defeated if a debtor were able to jump an unrecorded security interest over the trustee's status on behalf of other creditors by mentioning it when the debtor filed the petition.

594 F.3d at 1078 (footnotes omitted).

Petitioner cites no authority which would compel this Court to deviate from the current state of the law. Indeed, Petitioner recognizes that the petition and the schedules are in fact different documents, and that Bankruptcy Rule 1007(b) allows the debtor to file schedules 15 days after a petition is filed. *See* Fed. R. Bankr.P. Rule 1007(b). Pet., p. 17.

Petitioner has not advanced any sound reasoning for changing the existing law in this regard. As the BAP stated, "[w]e do not ignore binding precedent nor do we speculate further. We simply construe *Professional Investment* to be limited in its application to an involuntary petition wherein the petitioning creditor asserts its lien. We express no opinion as to the outcome in any future case wherein a voluntary petitioner departs from Official Form 1 and inserts information about a creditor." 361 B.R. at 516, n. 7. As a result, this petition is not worthy of a grant of certiorari.

II. The Decisions Below Are Correct, and the Decision of the Ninth Circuit Court of Appeals Is Not in Conflict With Applicable California State Law.

Review by this Court is also unnecessary because both the BAP and the Ninth Circuit reached the right conclusion based on the facts of this case, and even considering the framework provided in *Professional Investment*. Petitioner suggests, without support, that the Ninth Circuit decision "abrogated California law

where that law controls the federal question of the trustee's avoiding powers under section 544(a)(3)." Pet., p. 27. Yet, the authorities cited by Petitioner were indeed cited to and considered by the BAP and the Ninth Circuit courts in their respective decisions.

Both the BAP and the Ninth Circuit, as well as the parties, agree that Section 544(a)(3) imbues a trustee with all of the rights and powers of a bona fide purchaser of real property, and that those rights are defined under the law of the state in which the real property is located. 594 F.3d at 1078-79, citing *Robertson v. Peters (In re Weisman)*, 5 F.3d 417, 420 (9th Cir. 1993), a case relied upon by Petitioner. The Ninth Circuit examined Petitioner's argument in this regard and found it without merit:

> California law provides that a conveyance, "from the time it is filed with the recorder for record is constructive notice of the contents thereof to subsequent purchasers and mortgagees." [Cal. Civil Code Section 1213.] Chase Manhattan did not record, so the trustee did not have constructive notice of its lien. Under California law, a conveyance is "void as against any subsequent purchaser or mortgagee of the same property, or any part thereof, in good faith and for a valuable consideration, whose conveyance is first duly recorded." [Cal. Civil Code Section 1214.] The strong arm clause enables the trustee to avoid an unrecorded lien as if he were "a bona fide purchaser of real property, other than fixtures, from the debtor, against whom

> applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case." [11 U.S.C. § 544(a)(3).] That means that we are to deem the trustee not only to have purchased the property for value without notice of the unrecorded lien, but also to have recorded his deed when the petition was filed. It is as though he were shopping for a place to live, saw a classified ad, bought the condo after doing a title search, and recorded the deed, all at the instant the petition was filed. Under California law, such recording would render Chase Manhattan's lien void.

594 F.3d at 1078-79.

Petitioner cites, among other cases, *Newhall v. Hatch*, 134 Cal. 269 (1901); *Wolf v. Mahrdt (In re Chenich)*, 100 B.R. 512 (9th Cir. BAP 1987); *Buehler v. Oregon-Washington Plywood Corp.*, 17 Cal.3d 520 (1976) and *Robertson v. Peters (In re Weisman)*, 5 F.3d 417, 420 (9th Cir. 1993) for the propositions that a subsequent purchaser is put on inquiry notice by certain events, including prior recorded documents, and thus had a duty to inquire further regarding the property. Again, the fact which distinguishes these cases from the instant one is the fact that, in those cases, the documents which purport to convey notice were already recorded while, here, Petitioner's deed of trust was not.

Contrary to Petitioner's suggestion, the Ninth Circuit's decision was indeed in conformity with the applicable tenets of state law in this area. As a result, Petitioner's argument that the Ninth Circuit decision is in conflict with California law, must fail.

CONCLUSION

In its conclusion the BAP stated:

> Section 544(a)(3) grants the bankruptcy trustee for the benefit of all creditors the rights of a bona fide purchaser of the real property "as of the commencement of the case." A debtor's bankruptcy schedules and other required documents cannot be filed until there is a case in which to file them, so by definition they cannot impart any constructive or inquiry notice until after commencement of the case. Nothing in Debtor's bankruptcy schedules or SFA has any bearing on Trustee's statutory strong arm power to avoid Chase's Unrecorded Deed of Trust.

361 B.R. at 518. The Ninth Circuit agreed. Nothing in the Petition compels this Court to reconsider that well-reasoned and recited rule in this case.

Petitioner has failed to establish any basis upon which this Court should grant the Petition and consider Chase's arguments against the Ninth Circuit's

decision in this matter. The Petition for a Writ of Certiorari should be denied.

Dated: June 2, 2010

Respectfully submitted,

MICHAEL Y. MACKINNON*
KATHLEEN A. CASHMAN-KRAMER
PYLE SIMS DUNCAN & STEVENSON APC
401 "B" Street, Suite 1500
San Diego, CA 92101
Tel: 619-687-5200
Fax: 619-687-5210
Email: miguelm@psdslaw.com
Attorneys for Respondent
Harold S. Taxel, Chapter 7 Trustee

**Counsel of Record*

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No. 09-1334

Supreme Court, U.S.
JUN 14 2010
OFFICE OF THE CLERK

In The
Supreme Court of the United States

CHASE MANHATTAN BANK, USA, N.A.,

Petitioner,

vs.

HAROLD S. TAXEL, Chapter 7 Trustee,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITIONER'S REPLY TO BRIEF IN OPPOSITION

JAMES C. MITCHELL*
MITCHELL | GILLEON LAW FIRM
1320 Columbia Street, Suite 200
San Diego, CA 92101
Tel: 619.702.8623
Fax: 619.702.6337
Email: jcm@mglawyers.com

Attorneys for Petitioner
Chase Manhattan Bank, USA, N.A.
**Counsel of Record*

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

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ADDITIONAL REASONS TO GRANT THE WRIT

1. The Existing Case Law Shows Why This Case Presents An Important And Unique Federal Question Requiring Review.

Respondent Harold S. Taxel, Chapter 7 Trustee ("Taxel"), claims, without referring to any particular language in the case, that the holding in ***Briggs v. Kent (In re Professional Investment Properties of America)***, 955 F.2d 623, cert. denied, 506 U.S. 818, rehearing denied 506 U.S. 1015 (9th Cir. 1992) that a debtor's bankruptcy petition could provide inquiry or constructive notice under applicable state law of an unrecorded interest in a debtor's real property, was limited to involuntary petitions. The case did involve notice gained from an involuntary petition, but no language in the case (or later cases, other than the decisions by the Bankruptcy Appellate Panel "BAP" and the Ninth Circuit Court of Appeals in the present case) limited the holding to involuntary petitions, as opposed to voluntary bankruptcy petitions.

Professional Investment first determined that a bankruptcy petition is part of the public record and a hypothetical purchaser of real property, like a bankruptcy trustee, has notice of – "a diligent title search would disclose the bankruptcy filing" and "a reasonably prudent purchaser of debtor's property would be placed on notice of the contents of bankruptcy pleadings from the time of their being filed." ***Id.*** at 627. The court then held that inquiry or constructive notice of an interest in a debtor's real property attained by a bankruptcy trustee simultaneous with the

filing of the petition was sufficient to defeat a trustee's hypothetical bona fide purchaser status under 11 U.S.C. § 544(a)(3). The specific language was, "there is no practical reason why a trustee should not be put on inquiry notice by the very petition that created his position." ***Id.*** at 628.

Thus, the holding in ***Professional Investment*** was not limited to involuntary petitions, but held that a trustee could be charged with inquiry or constructive notice of an interest in debtor's real property under applicable state law if such notice came simultaneously with the bankruptcy filing, such as, from a bankruptcy petition. Later case law, except for the appellate decisions in the present case, have followed this principle.

Taxel claims no published decision has determined that inquiry or constructive notice sufficient to defeat the section 544(a)(3) bona fide purchaser status of a trustee could be imparted by a debtor's concurrently filed schedules in a voluntary chapter 7 case. Not so.

Decker v. J. Cyril Johnson Corporation Profit Sharing Plan (In re Harvey), 222 B.R. 888 (9th Cir. BAP 1998), relied on ***Professional Investment*** and involved whether a debtor's concurrently filed schedules with a chapter 7 petition could impart inquiry or constructive notice of an unrecorded interest in a debtor's real property under California Civil Code § 19. ***Harvey*** at 893. The BAP determined, under California law, that inquiry notice of an

unrecorded interest in a debtor's real property could be provided to the trustee by a debtor's concurrently filed schedules. ***Id.*** at 893, 895, 896. The court found that the schedules did not actually provide notice of an interest in real property, but only of an interest in the sales proceeds from the property. ***Id.*** at 895, 896.

Joseph v. Hewitt (In re Castro), 15 B.R. 180 (Bnkr. C.D. Cal. 1993), like ***Harvey***, relied on ***Professional Investment***. It too applied California Civil Code § 19 to the issue of inquiry or constructive notice of an unrecorded interest in real property. The bankruptcy court held that information contained in a debtor's schedules that were not concurrently filed with a petition came too late to provide the trustee with inquiry or constructive notice simultaneous with the petition. ***Castro*** at 183; see also ***Huber v. Danning (In re Thomas)***, 147 B.R. 526 (9th Cir. BAP 1992) and ***Little v. Duncombe (In re Duncombe)***, 143 B.R. 243 (Bnkr. C.D. Cal. 1992) (two cases that relied on ***Professional Investment*** in determining if a bankruptcy trustee was put on inquiry or constructive notice of an interest in a debtor's real property simultaneous with the bankruptcy filing.)

One published bankruptcy court decision has disagreed with ***Professional Investment's*** holdings, ***Kohut v. Quicken Loans, Inc. (In re Wohlfeil)***, 322 B.R. 302 (Bnkr. E.D. Mich. 2005). This case applied Michigan law to the issue of inquiry notice of an unrecorded deed of trust sufficient to defeat a trustee's bona fide purchaser status under section 544(a)(3), which law is identical to California law. See ***Wohlfeil***

at 305. The bankruptcy court criticized the ***Professional Investment*** holding that a trustee's bona fide purchaser status under section 544(a)(3) can be defeated by the contents of a bankruptcy petition. The court stated that this status cannot be undone by information in a debtor's voluntary petition (or as the creditor claimed in ***Wohlfeil***, from information contained in concurrently filed schedules). ***Id.*** at 305, 306.

There are no conflicting appellate decisions from different circuits about whether a bankruptcy petition, as well as concurrently filed schedules, can, simultaneously with a bankruptcy filing, provide a trustee with inquiry or constructive notice of an interest in a debtor's real property under applicable state law. However, the published appellate and bankruptcy cases out of the Ninth Circuit, ***Professional Investment*** and those cases that relied on its holding, and the decisions in this case, are in conflict over the scope of the holding in ***Professional Investment*** and whether concurrently filed schedules can provide inquiry or constructive notice to a trustee simultaneously with a bankruptcy filing of an interest in a debtor's real property.

The holding in ***Professional Investment***, that inquiry notice simultaneous with the bankruptcy filing is sufficient to defeat the trustee's bona fide purchaser status, means that schedules filed at the same instant as the petition can provide such notice. ***Harvey*** agreed with this principle, as did the analysis and holding in ***Castro***. The decisions in the

present case have said no to this simple, practical approach to defining a trustee's strong-arm powers under section 544 (a)(3).

Whether a debtor's electronically filed schedules, filed at the same instant as a voluntary petition and noted on the court's docket as a single filing, can provide inquiry or constructive notice of an interest in a debtor's real property sufficient to defeat a trustee's strong-arm powers under section 544(a)(3), presents a unique issue, and a timely one, considering today's economy and the universal use of instant electronic transmission of the written word to conduct business. Couple this with the conflicting decisions out of the Ninth Circuit, the fact that the trustee's strong-arm powers are, undoubtedly, an important federal question, and the fact this court has yet to decide the issue, and compelling reasons for granting the writ have been demonstrated. Albert Einstein once observed that "[e]verything should be made as simple as possible, but not simpler." Review is needed to make the issue as simple as possible, not what is, simpler.

2. The Court Of Appeals Decision Abrogates And Conflicts With California Supreme Court Decisions On When A Purchaser Of Real Property Has Inquiry Or Constructive Notice Of Matters Affecting Title To Real Property.

Taxel claims that the BAP and Ninth Circuit decisions do not abrogate California Supreme Court decisions on inquiry or constructive notice because

the bankruptcy petition was not recorded. This is incorrect.

The inquiry notice cases cited by Chase all stand for the principle that when a prospective purchaser of real property has notice of matters or information concerning the property sufficient to put a prudent person on inquiry as to a particular fact, that person has constructive notice of the fact itself that in all cases a reasonable inquiry would have revealed. See ***Lent v. Morrill,*** 25 Cal. 492, 500, 501 (1864), ***Newhall v. Hatch,*** 134 Cal. 269, 275 (1901), ***Buehler v. Oregon-Washington Plywood Corp.,*** 17 Cal.3d 520, 529, 530 (1976) and ***Dexter v. Pierson,*** 214 Cal. 247, 250, 251 (1931). The documents in these cases that provided facts putting a prospective purchaser of real property on inquiry notice were recorded documents. However, the holding and principle of inquiry notice announced in these cases was not limited to notice gained solely from recorded documents, but notice of any circumstances sufficient to put a prudent purchaser on notice of facts requiring an inquiry. See ***Lent*** at 501, ***Newhall*** at 275, ***Buehler*** at 530, ***Dexter*** at 251; see also California Civil Code § 19.

The decisions by the BAP and the Ninth Circuit have set a contrary precedent. Both decisions concede a bankruptcy trustee has notice of the bankruptcy petition and, in turn, inquiry or constructive notice under applicable state law of facts concerning a debtor's real property at the instant the bankruptcy petition is filed, including information in the petition

itself. So far, so good in following established California precedent on this issue. But, the decisions went on to hold that the inquiry notice provided to a trustee by the petition, under California law, did not extend to or put the trustee on inquiry notice of other documents or matters described in the petition, or in pleadings required to be filed with the petition.

This part of the decisions directly conflicts with the California Supreme Court decisions, ***Lent***, ***Newhall***, ***Buehler***, and ***Dexter*** that construe the inquiry notice statute, California Civil Code § 19. These cases hold that once a prospective purchaser of real property has notice of facts (that may or may not be in a recorded document) that purchaser, under California Civil Code § 19, also has constructive notice of all matters that a proper inquiry into those facts would have revealed. See ***Lent*** at 501, ***Newhall*** at 275, ***Buehler*** at 530, ***Dexter*** at 251.[1]

The BAP and the Ninth Circuit have held otherwise, determining the bankruptcy petition did not put the trustee on inquiry notice of matters in the debtor's earlier chapter 13 bankruptcy that was required by law to be and was described in the petition. This

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[1] At least one published Ninth Circuit BAP decision, ***Wolf v. Mahrdt (In re Chenich)***, 100 B.R. 512 (9th Cir. BAP 1987), applied the holding and principle in ***Newhall***, finding that a bankruptcy trustee had inquiry notice of an extension of a due date of a promissory note, where the promissory note, and any extensions of it, were referred to in a recorded document, a deed of trust. See ***Chenich*** at 513, 514.

included information in the earlier case stating the debtor's condominium was encumbered by the Chase deed of trust, a fact contrary to the county recorder's records that showed a Chase deed of trust had been reconveyed and there were no mortgages or deeds of trust against the property. This contrary precedent was extended to disregard facts contained in bankruptcy pleadings required by F.R.B.P., Rule 1007(b) to be filed with the petition, a list of the names and addresses of creditors. One of the creditors named on this pleading was "Chase Manhattan Mortgage." The word mortgage instantly conveys the meaning of a debt secured by the debtor's real property to the hypothetical reasonably prudent purchaser, like a bankruptcy trustee. This fact also contradicts the public records, that showed there was no Chase mortgage or deed of trust, or any mortgage or deed of trust, against the property. The California Supreme Court cases hold these facts constitute inquiry and, in turn, constructive notice of the Chase deed of trust.

Contrary to Taxel's position, the BAP and Ninth Circuit decisions do abrogate California Supreme Court decisions on the extent and scope of inquiry notice of matters affecting title to real property.

3. Conclusion.

The Court of Appeals correctly described a bankruptcy trustee's hypothetical bona fide purchaser status under 11 U.S.C. § 544(a)(3) as – "[i]t is as though he were shopping for a place to live, saw a classified

ad, bought the condo after doing a title search [found no Chase deed of trust] and recorded a deed, all at the instant the petition was filed." (Appendix 13, 14.) "And now, for the rest of the story" – at that very same instant, the earlier bankruptcy case mentioned in the petition and the bankruptcy pleadings filed with the petition, the creditor's list and the schedules, revealed contrary facts to the trustee, there was a Chase deed of trust.[2] In reality, it is as though the trustee went to the condo as he was recording the deed and was told by Ms. Deuel about the deed of trust. Review by this court will ensure that in future situations involving the extent of a bankruptcy trustee's powers under section 544(a)(3) that the full story will be told.

An old Turkish proverb says that "no matter how far you have gone on the wrong road, turn back." The writ should be granted.

Dated: June 13, 2010

MITCHELL & GILLEON

JAMES C. MITCHELL,
Attorneys for Petitioner Chase Manhattan Bank, USA, N.A.

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[2] The late radio and television commentator Paul Harvey's famous byline.